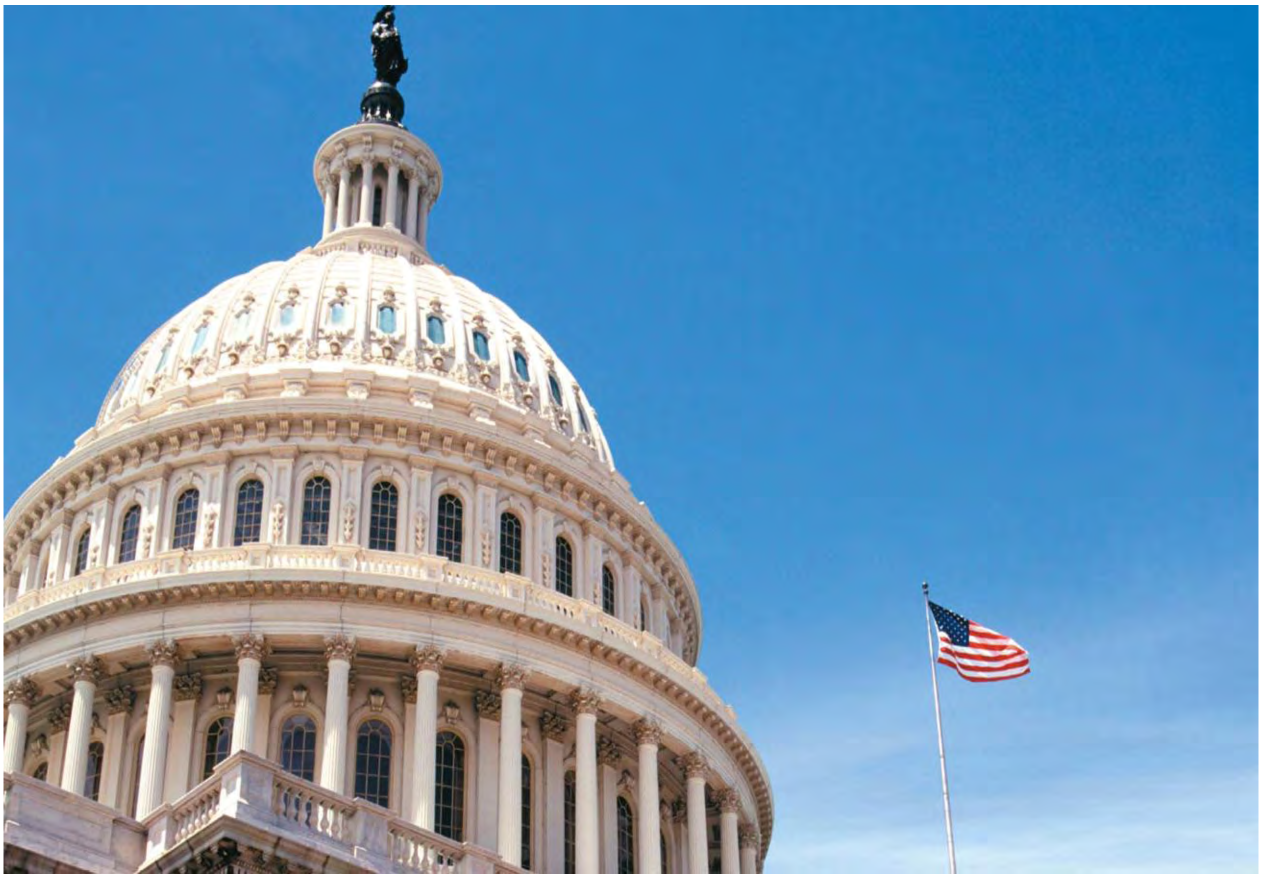
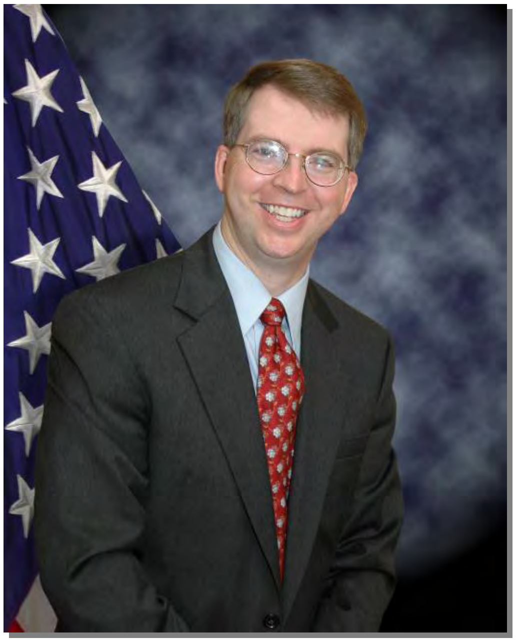
Financial Information



The ***Financial Information*** demonstrates our commitment to effective stewardship over the funds DHS receives to carry out the mission of the Department, including compliance with relevant financial management legislation. It includes the ***Independent Auditors' Report***, an independent auditors' report on the Balance Sheet and Statement of Custodial Activities provided by the Department's Office of Inspector General (OIG), and provides the Department's ***Annual Financial Statements*** and accompanying ***Notes to the Financial Statements***.

Message from the Chief Financial Officer

November 14, 2008



The Annual Financial Report is our principal financial statement of accountability to the President, Congress and the American public, documenting the Department's progress in financial management and stewardship of taxpayer dollars.

More than five years ago, DHS financial management began with limited infrastructure, non-existent business processes, scarce office supplies and a handful of dedicated staff detailed to build the organization from the ground up. We inherited 18 material weaknesses and were put on the Government Accountability Office's high-risk list from day one. What did exist was the desire to make it work. Through strong leadership and the hard work of our teams, we put in place strong internal controls, critical workforce training, and sound policies – the fundamental building blocks for effective financial management.

Since the passage of the DHS Financial Accountability Act in 2004, the Department has worked collaboratively with Congress, the Government Accountability Office, OMB, DHS Office of the Inspector General, and our independent auditor to ensure we achieve the Act's intended outcome of strengthening financial management to support the Department's mission.

The Fiscal Year (FY) 2008 audit shows we continue to make measurable progress and that our corrective actions and internal controls are working. Earlier this year, we released the second edition of the Internal Control Playbook outlining our plan to resolve material weaknesses and build management assurances. I am particularly encouraged with how the corrective actions process has been sustained. Although we know DHS still faces financial management challenges, the auditor acknowledges the significant progress we've made this year and over the past four years. Consider these highlights:

- We reduced the number of material weaknesses from ten in FY 2006, to seven in FY 2007, to six in FY 2008;
- We reduced the number of component conditions contributing to material weaknesses from twenty-five in FY 2006, to sixteen in FY 2007, to thirteen in FY 2008;
- We reduced Department-wide audit qualifications from ten in FY 2006, to six in FY 2007 to three in FY 2008; and
- Fifty percent of our budget is now managed by Components with no material weaknesses compared to seven percent in FY 2005.

Audit challenges remain, albeit in much more focused areas. We will continue to partner with the U.S. Coast Guard, Transportation Security Administration and the Federal Emergency

Management Agency (FEMA) to help resolve material weakness conditions and build upon their demonstrated success. In FY 2008:

- FEMA reduced the severity on half of their prior year material weaknesses;
- The Transportation Security Administration corrected prior year material weakness conditions related to Other Liabilities and Budgetary Accounting; and
- U.S. Coast Guard and FEMA reduced the severity of Departmental Financial Management and Oversight to a reportable condition, a first ever material weakness remediation at U.S. Coast Guard.

We also recognize that strong, stable financial management operations do not rest on one element alone. Over the past several years we have made a concerted effort for comprehensive improvements:

- We improved the efficiency of transaction processing by paying 96 percent of vendors electronically to save taxpayer dollars, reduce paperwork, and strengthen cash management.
- The Department strengthened compliance with the *Improper Payments Information Act*, performed risk assessments to identify programs susceptible to improper payments, tested payments to estimate errors, implemented corrective action plans, and reported results.
- We established a Workforce Development Program to provide training and tools to support job execution, career path development, and talent management to recruit the next generation of financial management leaders. To date, more than 300 employees have been trained in our New Hire Orientation Program.
- We launched the Financial Management Policy Manual online repository which provides DHS guidance for program and budget formulation, budget execution, financial management, accounting, and reporting. In addition, the Manual provides a foundation for a system of effective internal controls to help the Department accomplish its financial management goals and prevent and detect potential waste, fraud, and abuse.
- In 2008, our Performance and Accountability Report was ranked fifth across the federal government for providing effective information on the public benefit and positive outcomes DHS delivers and accounting for our use of tax-payers dollars – achieving a double-digit climb in the rankings from 21st the previous year.

Financial management has come a long way at DHS since its inception. I continue to be inspired by the extraordinary efforts of our dedicated staff at Headquarters and in the Components. We have established a culture of integrity and accountability in all we do. It has been my honor to serve as the Department's Chief Financial Officer. I am pleased we have established a solid foundation in financial management to help ensure the continued success of the Department of Homeland Security.

Sincerely,

David L. Norquist

David L. Norquist
Chief Financial Officer

Introduction

The principal financial statements included in this report are prepared pursuant to the requirements of the *Chief Financial Officers Act of 1990 (P.L. 101-576),* as amended by the *Government Management Reform Act of 1994 (P.L. 103-356)*. Other requirements include the Office of Management and Budget (OMB) Circular Number A-136, *Financial Reporting Requirements*. The responsibility for the integrity of the financial information included in these statements rests with the management of DHS. An independent certified public accounting firm, selected by the Department's Inspector General, was engaged to audit the Balance Sheet and the Statement of Custodial Activity. The independent auditors' report accompanies the principal financial statements. These financial statements include the following:

- The **Balance Sheets** present as of September 30, 2008 and 2007, those resources owned or managed by DHS which represent future economic benefits (assets); amounts owed by DHS that will require payments from those resources or future resources (liabilities); and residual amounts retained by DHS comprising the difference (net position).

- The **Statements of Net Cost** present the net cost of DHS operations for the fiscal years ended September 30, 2008 and 2007. DHS net cost of operations is the gross cost incurred by DHS less any exchange revenue earned from DHS activities.

- The **Statements of Changes in Net Position** present the change in DHS's net position resulting from the net cost of DHS operations, budgetary financing sources, and other financing sources for the fiscal years ended September 30, 2008 and 2007.

- The **Statements of Budgetary Resources** present how and in what amounts budgetary resources were made available to DHS during FY 2008 and FY 2007, the status of these resources at September 30, 2008 and 2007, the changes in the obligated balance, and outlays of budgetary resources for the fiscal years ended September 30, 2008 and 2007.

- The **Statements of Custodial Activity** present the disposition of custodial revenue collected and disbursed by DHS on behalf of other recipient entities for the fiscal years ended September 30, 2008 and 2007.

- The **Notes to the Financial Statements** provide detail and clarification for amounts on the face of the Financial Statements for the fiscal years ended September 30, 2008 and 2007.

Limitations of Financial Statements

The principal financial statements have been prepared to report the financial position and results of operations of the Department, pursuant to the requirements of Title 31, United States Code, Section 3515 (b) relating to financial statements of Federal agencies. While the statements have been prepared from the books and records of the agency in accordance with U.S. Generally Accepted Accounting Principles (GAAP) for Federal agencies and the formats prescribed by OMB, the statements are in addition to the financial reports used to monitor and control budgetary resources which are prepared from the same books and records. The statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity.

Independent Auditors' Report

Department of Homeland Security
Office of Inspector General

Independent Auditors' Report on DHS' FY 2008 Financial Statements

OIG-09-09

November 2008

Office of Inspector General

U.S. Department of Homeland Security
Washington, DC 20528

Homeland Security

November 15, 2008

Preface

The Department of Homeland Security (DHS) Office of Inspector General (OIG) was established by the Homeland Security Act of 2002 (*Public Law 107-296*) by amendment to the *Inspector General Act of 1978*. This is one of a series of audit, inspection, and special reports prepared as part of our oversight responsibilities to promote economy, efficiency, and effectiveness within the department.

The attached report presents financial information excerpted from DHS' *Annual Financial Report* (AFR) and the results of the DHS financial statement audits for fiscal year (FY) 2008 and FY 2007. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the audits. The contract required that KPMG perform its audits according to generally accepted government auditing standards and guidance from the Office of Management and Budget and the Government Accountability Office. KPMG was unable to provide an opinion on DHS' balance sheet as of September 30, 2008 and 2007. The FY 2008 auditor's report discusses nine significant deficiencies, six of which are considered material weaknesses in internal control, and eight instances of noncompliance with laws and regulations. KPMG is responsible for the attached auditor's report dated November 14, 2008, and the conclusions expressed in the report. We do not express opinions on DHS' financial statements or internal control or conclusions on compliance with laws and regulations.

The recommendations herein have been discussed in draft with those responsible for implementation. It is our hope that this report will result in more effective, efficient, and economical operations. We express our appreciation to all of those who contributed to the preparation of this report.

Richard L. Skinner

Richard L. Skinner
Inspector General

U.S. DEPARTMENT OF HOMELAND SECURITY

Excerpts from the DHS Annual Financial Report

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Office of Inspector General

U.S. Department of Homeland Security
Washington, DC 20528

November 15, 2008

MEMORANDUM FOR: The Honorable Michael Chertoff
Secretary

Richard L. Skinner

FROM: Richard L. Skinner
Inspector General

SUBJECT: Independent Auditors' Report on DHS' FY 2008 Balance Sheet and Statement of Custodial Activity

The attached report presents the results of the Department of Homeland Security's (DHS or department) financial statement audits for fiscal year (FY) 2008 and FY 2007. These are mandatory audits required by the *Chief Financial Officers Act of 1990* as amended by *Department of Homeland Security Financial Accountability Act of 2004*. This report is incorporated into the department's FY 2008 *Annual Financial Report*. We contracted with the independent public accounting firm KPMG LLP (KPMG) to perform the audits.

Generally the mission action plans for DHS' components showed results of continued improvement in financial reporting during FY 2008, although overall the department still has much work remaining. For the fifth year, KPMG was unable to provide an opinion on the department's balance sheet; although elements and conditions of prior year weaknesses have been corrected, except for the improvement in Entity-Level Controls, the material weakness conditions at the department exist in many of the same processes as in prior years.

Summary

KPMG was unable to express an opinion on the department's balance sheets as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended, because DHS was unable to represent that certain financial statement balances were correct, and was unable to provide sufficient evidence to support its financial statements. In connection with the audits, KPMG also considered DHS' internal controls over financial reporting and compliance with certain provisions of laws and regulations. As a result, the FY 2008 Independent Auditors' Report discusses six significant deficiencies considered to be material weaknesses, three other significant deficiencies in internal control, and eight instances of non-compliance with laws and regulations, as follows:

Significant Deficiencies That Are Considered To Be Material Weaknesses

A. Financial Reporting
B. Financial Systems General and Application Controls
C. Fund Balance with Treasury
D. Capital Assets and Supplies
E. Actuarial and Other Liabilities
F. Budgetary Accounting

Other Significant Deficiencies

G. Entity-Level Controls
H. Custodial Revenue and Drawback
I. Deferred Revenue

Non-compliance with Laws and Regulations

J. *Federal Managers' Financial Integrity Act of 1982* (FMFIA)
K. *Federal Financial Management Improvement Act of 1996* (FFMIA)
L. *Single Audit Act Amendments of 1996,* and laws and regulations supporting OMB Circular No. A-50, *Audit Follow-up*, as revised
M. *Improper Payments Information Act of* 2002 (IPIA)
N. Chief Financial Officers Act of 1990
O. *Government Performance and Results Act of 199*3 (GPRA)
P. *Debt Collection Improvement Act of 1996* (DCIA)
Q. Anti-deficiency Act

Moving DHS' Financial Management Forward

While the auditors noted improvement toward correction of internal control weaknesses, the department was unable to represent that its financial statements as of, and for the year ended, September 30, 2008, were presented in conformity with U.S. generally accepted accounting principles. The U.S. Coast Guard (USCG), Transportation Security Administration (TSA), and the Federal Emergency Management Agency (FEMA), were unable to provide sufficient evidence to support account balances presented in the financial statements and collectively contributed to the auditors' inability to render an opinion.

Since last year, the department was able to reduce the number of conditions leading to the independent auditors disclaimer of opinion on DHS' financial statements from six to three. As a result, OFM and the Office of Health Affairs (OHA) no longer contribute to the disclaimer conditions and FEMA remediated all its prior year disclaimer conditions. However, during the FY 2008 audit new disclaimer conditions were identified at TSA and FEMA. TSA was unable to assert that its capital asset balances are fairly stated and FEMA was unable to assert that its capital asset balances, related to internal use software, are fairly stated respectively, at September 30, 2008.

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The Coast Guard began FY 2008 with a focus on Entity-Level Controls, and the military portion of the fund balance with Treasury. During FY 2008, Coast Guard made initial steps toward improvements to procedural, control, and personnel by chartering the Senior Management Council (SMC) and revising its Financial Strategy for Transformation and Audit Readiness (FSTAR). To update FSTAR, Coast Guard performed an in-depth root cause analysis that identified seventeen areas for improvement. However, the Coast Guard was unable to fully remediate prior year control weaknesses, and the auditors again reported that the Coast Guard contributed to all six material weaknesses and the Entity-Level Controls significant deficiency.

Many of the DHS' challenges in financial management and reporting can be attributed to the original stand-up of a large, new, and complex executive branch agency without adequate organizational expertise in financial management and accounting. The department made modest progress in remediating weaknesses during FY 2008 and remains committed to focusing on remediation efforts at USCG, FEMA, and TSA, while sustaining progress made throughout FY 2008. During the past year, the department and its components continued the extensive effort to develop meaningful mission action plans to address specific material internal control weaknesses. We are evaluating the effectiveness of those mission action plans in a separate series of audits.

*****

KPMG is responsible for the attached independent auditor's report dated November 14, 2008, and the conclusions expressed in the report. We do not express opinions on financial statements or internal control or conclusions on compliance with laws and regulations.

Consistent with our responsibility under the *Inspector General Act*, we are providing copies of this report to appropriate congressional committees with oversight and appropriation responsibilities over the department. In addition, we will post a copy of the report on our public website.

We request that each of the department's chief financial officers provide us with a corrective action plan that demonstrates progress in addressing the report's recommendations.

We appreciate the cooperation extended to the auditors by the department's financial offices. Should you have any questions, please call me, or your staff may contact Anne Richards, Assistant Inspector General for Audits, at 202-254-4100.

Attachment

KPMG LLP
2001 M Street, NW
Washington, DC 20036

INDEPENDENT AUDITORS' REPORT

Secretary and Inspector General
U.S. Department of Homeland Security:

We were engaged to audit the accompanying balance sheets of the U.S. Department of Homeland Security (DHS or Department) as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended (referred to herein as "financial statements"). In connection with our fiscal year (FY) 2008 audit, we also considered DHS' internal controls over financial reporting, and DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements that could have a direct and material effect on these financial statements. We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources, for the years ended September 30, 2008 and 2007 (referred to herein as "other FY 2008 and 2007 financial statements").

Summary

As discussed in our report on the financial statements, the scope of our work was not sufficient to express an opinion on the DHS balance sheets as of September 30, 2008 and 2007, or the related statements of custodial activity for the years then ended.

As discussed in Note 1.X to the financial statements, in FY 2008, DHS changed its method of accounting for a budgetary allocation transfer made by the Office of Health Affairs (OHA), a DHS component, to another Federal agency.

Our consideration of internal control over financial reporting resulted in the following conditions being identified as significant deficiencies:

A. Financial Reporting
B. Information Technology General and Application Controls
C. Fund Balance with Treasury
D. Capital Assets and Supplies
E. Actuarial and Other Liabilities
F. Budgetary Accounting
G. Entity Level Controls
H. Custodial Revenue and Drawback
I. Deferred Revenue

We consider significant deficiencies A through F, above, to be material weaknesses.

The results of our tests of compliance with certain provisions of laws, regulations, contracts, and grant agreements disclosed the following instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*, issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements*:

J. *Federal Managers' Financial Integrity Act of 1982* (FMFIA)
K. *Federal Financial Management Improvement Act of 1996* (FFMIA)
L. *Single Audit Act Amendments of 1996*, and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-up,* as revised
M. *Improper Payments Information Act of 2002*
N. *Chief Financial Officers Act of 1990*
O. *Government Performance and Results Act of 1993*
P. *Debt Collection Improvement Act of 1996*
Q. *Anti-deficiency Act*

KPMG

We also reported other matters related to compliance with the *Anti-deficiency Act* at the National Protection and Programs Directorate (NPPD), Federal Emergency Management Agency (FEMA), U.S. Coast Guard (USCG) and Federal Law Enforcement Training Center (FLETC).

Other internal control matters and other instances of non-compliance may have been identified and reported had we been able to perform all procedures necessary to express an opinion on the DHS balance sheets as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended, and had we been engaged to audit the other fiscal year 2008 and 2007 financial statements.

The following sections discuss the reasons why we are unable to express an opinion on the accompanying DHS balance sheets as of September 30, 2008 and 2007, and on the statements of custodial activity for the years then ended; our consideration of DHS' internal control over financial reporting; our tests of DHS' compliance with certain provisions of applicable laws, regulations, contracts, and grant agreements and other matters; and management's and our responsibilities.

Report on the Financial Statements

We were engaged to audit the accompanying balance sheets of the U.S. Department of Homeland Security as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended. We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the years ended September 30, 2008 and 2007.

The United States Coast Guard (Coast Guard) was unable to provide sufficient evidential matter or make knowledgeable representations of facts and circumstances, that support transactions and account balances of the Coast Guard, as presented in the DHS balance sheets at September 30, 2008 and 2007; particularly with respect to fund balance with Treasury, accounts receivable, inventory and related property, certain categories of property, plant and equipment, actuarially-derived liabilities, environmental and other liabilities, undelivered orders and changes in net position, and adjustments, both manual and automated, made as part of Coast Guard's financial reporting process. The Coast Guard was unable to complete corrective actions and make adjustments, as necessary, to these and other balance sheet amounts, prior to the completion of the DHS FY 2008 *Annual Financial Report* (AFR). Because of the significance of these account balances and/or transactions and conditions noted above, DHS and Coast Guard management were unable to represent that the Coast Guard's balance sheets as of September 30, 2008 and 2007, were fairly stated in conformity with U.S. generally accepted accounting principles. The total assets of Coast Guard, as reported in the accompanying DHS balance sheet, were $17.4 billion and $15.9 billion, or 20 percent of total DHS consolidated assets in both years, as of September 30, 2008 and 2007, respectively.

The Transportation Security Administration (TSA) was unable to fully support the accuracy and completeness of certain capital asset balances and related effects on net position, if any, prior to the completion of the DHS FY 2008 AFR. The TSA capital assets as reported in the accompanying DHS balance sheet as of September 30, 2008, were $932 million or six percent of DHS' consolidated property, plant and equipment.

FEMA was unable to fully support the accuracy and completeness of certain capital assets balances related to internal use software, and related effects on net position, if any, prior to the completion of the DHS FY 2008 AFR. The FEMA capital assets related to internal use software, net as reported in the accompanying DHS balance sheet as of September 30, 2008 were $22 million or 0.2 percent of DHS' consolidated property, plant and equipment, net. In FY 2007, FEMA was unable to fully support the accuracy and completeness of certain stockpiled supplies, unpaid obligations related to mission assignments, and certain grants payable/advances, and the related effects on net position, if any, prior to the completion of the DHS FY 2007 AFR. The stockpiled supplies, as reported in the accompanying DHS balance sheet as of September 30, 2007, were $243 million or 38 percent of DHS' consolidated inventory and related property. FEMA's unpaid obligations related to mission assignments, as reported in the accompanying DHS balance sheet as of September 30, 2007, were $2.6 billion or five percent of DHS' consolidated unexpended appropriations. FEMA's net grants payable/advances, as reported in the DHS balance sheet as of September 30, 2007, were $149 million or three percent of DHS' consolidated accounts payable. The total net position of FEMA as reported in the accompanying DHS balance sheet as of September 30, 2007, was $10.1 billion or 13 percent of DHS' consolidated liabilities and net position.

In FY 2007, DHS Office of Financial Management (OFM) and certain DHS components were unable to reconcile intragovernmental transactions and balances with other Federal trading partners totaling approximately $1.5 billion as of September 30, 2007, prior to the completion of the DHS FY 2007 AFR.

In FY 2007, the DHS Office of Health Affairs (OHA) was unable to provide sufficient evidential matter to support its recording of $1.5 billion in both fund balance with Treasury and undelivered orders at September 30, 2007, resulting from a budgetary allocation transfer made by OHA to another Federal agency in FY 2007. Because of the significance of this allocation transfer, DHS management was unable to represent that the balance sheet of OHA was fairly stated in conformity with U.S. generally accepted accounting principles at September 30, 2007. The total assets of OHA, as reported in the accompanying DHS balance sheet as of September 30, 2007, were $3.3 billion or four percent of total DHS consolidated assets.

In addition, we were unable to obtain certain representations from DHS management regarding the matters described above, including representations as to compliance with U.S. generally accepted accounting principles, with respect to the accompanying DHS balance sheets and related statements of custodial activity as of and for the years ended September 30, 2008 and 2007, and were unable to determine the effect of the lack of such representations on the FY 2008 and 2007 DHS financial statements.

It was impractical to extend our procedures sufficiently to determine the extent, if any, to which the DHS balance sheets as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended, may have been affected by the matters discussed in the six preceding paragraphs. Accordingly, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements and the related notes thereto.

We were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the years ended September 30, 2008 and 2007, and accordingly, we do not express an opinion on these financial statements.

As discussed in Note 33, DHS restated its FY 2007 financial statements to correct multiple errors identified by TSA, Coast Guard, OHA, and FLETC, that required adjustment of balances previously reported in DHS' FY 2007 financial statements. Because of the matters discussed in the second paragraph above regarding our FY 2008 audit at Coast Guard, and the control deficiencies described in our report on internal control over financial reporting, we were unable to audit the restatements identified by Coast Guard, and accordingly, we have not concluded on the appropriateness of this accounting treatment or the restatement of the DHS balance sheet as of September 30, 2007.

As discussed in Note 1.X to the financial statements, in FY 2008, DHS changed its method of accounting for a budgetary allocation transfer made by the OHA to another Federal agency that required adjustment of balances previously reported in DHS' FY 2007 financial statements.

The information in the Management's Discussion and Analysis (MD&A), RSSI, and Required Supplementary Information (RSI) sections of the DHS AFR is not a required part of the financial statements, but is supplementary information required by U.S. generally accepted accounting principles. We were unable to complete limited procedures over MD&A, RSSI, and RSI as prescribed by professional standards because of the limitations on the scope of our audit described in the previous paragraphs of this section of our report. Certain information presented in the MD&A, RSSI, and RSI is based on FY 2008 and 2007 financial statements on which we have not expressed an opinion. We did not audit the MD&A, RSSI, and RSI, and accordingly, we express no opinion on it.

The information in Other Accompanying Information of DHS' FY 2008 AFR is presented for purposes of additional analysis, and is not a required part of the financial statements. This information has not been subjected to auditing procedures, and accordingly, we express no opinion on it.

Internal Control over Financial Reporting

Our consideration of the internal control over financial reporting was for the limited purpose described in the Responsibilities section of this report and would not necessarily identify all deficiencies in the internal control over financial reporting that might be significant deficiencies or material weaknesses.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects DHS' ability to initiate, authorize, record, process, or report financial data reliably in accordance with U.S. generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of DHS' financial statements that is more than inconsequential will not be prevented or detected by DHS' internal control over financial reporting. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by DHS' internal control.

Significant deficiencies in internal control over financial reporting and its operation are described in Exhibits I, II, and III. Deficiencies that are considered to be material weaknesses at the Coast Guard, when aggregated with deficiencies existing at other components at the consolidated level, are presented in Exhibit I. Deficiencies that are considered to be material weaknesses at other DHS components, when aggregated with deficiencies existing at the Coast Guard at the consolidated level, are presented in Exhibit II. Exhibit III presents significant deficiencies that are not considered to be material weaknesses when aggregated with deficiencies at all components at the consolidated level. As discussed in the Report on the Financial Statements section, the scope of our work was not sufficient to express an opinion on the balance sheets as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended, and accordingly, other internal control matters may have been identified and reported had we been able to perform all procedures necessary to express an opinion on those financial statements, and had we been engaged to audit the other FY 2008 and 2007 financial statements. A summary of the status of FY 2007 significant deficiencies is included as Exhibit V.

We also noted certain additional deficiencies involving internal control over financial reporting and its operation that we will report to the management of DHS in a separate letter.

Compliance and Other Matters

The results of certain of our tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in the FFMIA, disclosed eight instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04, and are described in Exhibit IV.

The results of our other tests of compliance as described in the Responsibilities section of this report, exclusive of those referred to in FFMIA, disclosed no other instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 07-04.

The results of our tests of FFMIA, disclosed instances described in Exhibits I, II and III where DHS' financial management systems did not substantially comply with (1) Federal financial management systems requirements, (2) applicable Federal accounting standards, and (3) the United States Government Standard General Ledger at the transaction level.

As discussed in our report on the financial statements, the scope of our work was not sufficient to express an opinion on the balance sheets as of September 30, 2008 and 2007, and the related statements of custodial activity for the years then ended, and accordingly, other instances of noncompliance with laws, regulations, contracts, and grant agreements may have been identified and reported, had we been able to perform all procedures necessary to express an opinion on those financial statements, and had we been engaged to audit the other FY 2008 and 2007 financial statements. In addition, because of the matters discussed in our report on the financial statements, we were unable to perform certain tests of compliance over the Prompt Payment Act and Titles 10, 14, 31 (as related to the Anti-deficiency Act), and 37 of the United States Code at the Coast Guard.

Other Matters. NPPD management has continued a review of the classification and use of certain funds that may identify a violation of the *Anti-deficiency Act*, or other violations of appropriations law in FY 2008 or in previous years. In addition, NPPD management has initiated a review of certain fees collected for attendance at a DHS sponsored annual conference that may identify a violation of the *Anti-deficiency Act*. FLETC management has identified a matter that has been reported as a violation of the *Anti-deficiency Act* related to the classification of a building lease. The Office of Inspector General (OIG) intends to review the classification of two other building leases at FLETC that may identify a violation of the *Anti-deficiency Act* that occurred during previous years. The OIG has initiated a review, at FEMA management's request, of certain expenditures occurring in previous years that may have violated the *Anti-deficiency Act*. Coast Guard management has initiated a review of the use of certain funds to construct assets in previous years that may identify a violation of the *Anti-deficiency Act*.

KPMG

Management's Response to Internal Control and Compliance Findings

DHS management has indicated in a separate letter immediately following this report that it concurs with the findings presented in Exhibits I, II, III, and IV of our report. We did not audit DHS' response, and accordingly, we express no opinion on it.

Responsibilities

Management's Responsibilities. Management is responsible for the financial statements; establishing and maintaining effective internal control; and complying with laws, regulations, contracts, grant agreements, and other matters applicable to DHS.

Auditors' Responsibilities. As discussed in the report on the financial statements section, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the DHS balance sheets as of September 30, 2008 and 2007, or on the related statements of custodial activity for the years then ended; and we were not engaged to audit the accompanying statements of net cost, changes in net position, and budgetary resources for the years ended September 30, 2008 and 2007.

In connection with our FY 2008 engagement, we considered DHS' internal control over financial reporting by obtaining an understanding of DHS' internal control, determining whether internal controls had been placed in operation, assessing control risk, and performing tests of controls as a basis for designing our audit procedures. We did not test all internal controls relevant to operating objectives as broadly defined by the FMFIA. The objective of our engagement was not to express an opinion on the effectiveness of DHS' internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of DHS' internal control over financial reporting. Further, other matters involving internal control over financial reporting may have been identified and reported had we been able to perform all procedures necessary to express an opinion on the DHS balance sheet as of September 30, 2008, and the related statement of custodial activity for the year then ended, and had we been engaged to audit the other FY 2008 financial statements.

In connection with our FY 2008 engagement, we performed tests of DHS' compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of the balance sheet amounts as of September 30, 2008, and the related statement of custodial activity for the year then ended, and certain provisions of other laws and regulations specified in OMB Bulletin No. 07-04, including the provisions referred to in Section 803(a) of FFMIA. We limited our tests of compliance to the provisions described in the preceding sentence, and we did not test compliance with all laws, regulations, contracts, and grant agreements applicable to DHS. However, providing an opinion on compliance with laws, regulations, contracts, and grant agreements was not an objective of our engagement, and accordingly, we do not express such an opinion. In addition, other matters involving compliance with laws, regulations, contracts, and grant agreements may have been identified and reported had we been able to perform all procedures necessary to express an opinion on the DHS balance sheet as of September 30, 2008, and the related statement of custodial activity for the year then ended, and had we been engaged to audit the other FY 2008 financial statements.

Restricted Use

This report is intended solely for the information and use of DHS management, DHS Office of Inspector General, OMB, U.S. Government Accountability Office, and the U.S. Congress, and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 14, 2008

Independent Auditors' Report
Introduction to Exhibits on Internal Control and Compliance and Other Matters

Our report on internal control over financial reporting and compliance and other matters is presented in accordance with *Government Auditing Standards,* issued by the Comptroller General of the United States. The internal control weaknesses, and findings related to compliance with certain laws, regulations, contracts, and grant agreements presented herein were identified during our engagement to audit the Department of Homeland Security (DHS or Department) balance sheet and related statement of custodial activity as of and for the year ended September 30, 2008. We were not engaged to audit the Department's FY 2008 statements of net cost, changes in net position, and budgetary resources (referred to as other FY 2008 financial statements). Our findings and the status of prior year findings are presented in five exhibits:

Exhibit I Significant deficiencies in internal control identified at the Coast Guard. All of the significant deficiencies reported in Exhibit I are considered material weaknesses that individually, or when combined with other significant deficiencies reported in Exhibit II, are considered material weaknesses at the DHS consolidated financial statement level.

Exhibit II Significant deficiencies in internal control identified at other DHS components (collectively referred to as DHS Civilian Components). All of the significant deficiencies reported in Exhibit II are considered material weaknesses that individually, or when combined with other significant deficiencies reported in Exhibit I, are considered material weaknesses at the DHS consolidated financial statement level.

Exhibit III Significant deficiencies that are not considered a material weakness at the DHS consolidated financial statement level.

Exhibit IV Instances of noncompliance with certain laws, regulations, contracts, and grant agreements that are required to be reported under *Government Auditing Standards* or Office of Management and Budget (OMB) Bulletin No. 07-04, *Audit Requirements for Federal Financial Statements.*

Exhibit V The status of our findings reported in FY 2007.

As stated in our Independent Auditors' Report, our consideration of internal control over financial reporting would not necessarily disclose all matters that might be significant deficiencies or instances of noncompliance. We were not engaged to audit the other FY 2008 financial statements. In addition, the scope of our work was not sufficient to express an opinion on the financial statements that we were engaged to audit; consequently, other internal control matters and instances of noncompliance may have been identified and reported had we been engaged to audit all of the FY 2008 financial statements, and had we been able to perform all procedures necessary to express an opinion on those financial statements.

The determination of which findings rise to the level of a material weakness is based on an evaluation of how all component conditions, considered in aggregate, may affect the DHS balance sheet as of September 30, 2008, or the related statement of custodial activity for the year then ended.

We have also performed follow-up procedures on findings identified in previous engagements to audit the DHS financial statements. All of the material weaknesses identified and reported in Exhibit I for the Coast Guard are repeated from our FY 2006 and FY 2007 report, and include updates for new findings resulting from our 2008 audit procedures. To provide trend information for the DHS Civilian Components, Exhibit II contains a Trend Table next to the heading of each finding, except Exhibit II-B, *IT General and Application Controls*. The Trend Tables in Exhibit II depict the severity and current status of findings by component that has contributed to that finding from 2006 through 2008. A summary of our findings in FY 2008 and FY 2007 are presented in the Tables below:

Table 1 Presents a summary of our internal control findings, by component, for FY 2008.

Table 2 Presents a summary of our internal control findings, by component, for FY 2007.

We have reported six material weaknesses at the Department level in FY 2008, which is reduced from seven reported in FY 2007. As reported in Exhibit III-G, *Entity Level Controls,* financial management and entity level control deficiencies reported as a material weakness in FY 2007 (Table 2, Comments I-A and II-A below), are reported as a significant deficiency in FY 2008 (Table 1, Comment III-G).

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TABLE 1 - SUMMARIZED DHS FY 2008 INTERNAL CONTROL FINDINGS

Comment / Control Deficiency		DHS Consol.	CG	DHS HQ	CBP	CIS	FEMA	FLETC	ICE	S&T	TSA	US Visit
			Military	Civilian Components								
Material Weaknesses:			Exhibit I	Exhibit II								
A	Financial Reporting	MW	MW	C			MW				MW	
B	IT General and App. Controls	MW	MW	C	SD	SD	MW	SD	C		MW	
C	Fund Balance with Treasury	MW	MW									
D	Capital Assets and Supplies	MW	MW		SD		MW				MW	C
E	Actuarial and Other Liabilities	MW	MW				SD	SD	SD	SD	C	
F	Budgetary Accounting	MW	MW		SD		MW				C	
Significant Deficiencies: Exhibit III												
G	Entity-Level Controls	SD										
H	Custodial Revenue and Drawback	SD										
I	Deferred Revenue	SD										

TABLE 2 - SUMMARIZED DHS FY 2007 INTERNAL CONTROL FINDINGS

Comment / Control Deficiency		DHS Consol.	CG	DHS HQ	CBP	CIS	FEMA	FLETC	ICE	S&T	TSA	US Visit
			Military	Civilian Components								
Material Weaknesses:			Exhibit I	Exhibit II								
A	Financial Management and ELC	MW	MW				MW					
B	Financial Reporting	MW	MW	MW			MW				SD	
C	Financial Systems Security	MW	MW	SD	SD		MW	SD	SD		MW	
D	Fund Balance with Treasury	MW	MW									
E	Capital Assets and Supplies	MW	MW				MW				SD	SD
F	Actuarial and Other Liabilities	MW	MW				MW				SD	
G	Budgetary Accounting	MW	MW				MW				MW	
Significant Deficiencies: Exhibit III												
H	Custodial Revenue and Drawback	SD										

C	Corrected in FY 2008
MW	Material Weakness (individually, or when combined with other components, result in Department level finding)
SD	Significant Deficiency (SD's in Exhibit II contribute to Department level material weakness)
	Contributing to a significant deficiency

All components of DHS, as defined in Note 1A – *Reporting Entity,* to the financial statements, were included in the scope of our engagement to audit the consolidated balance sheet of DHS as of September 30, 2008, and the related statement of custodial activity for the year then ended. Accordingly, our audit considered significant account balances and transactions of other DHS components not listed above. Control deficiencies identified in other DHS components that are not identified in the table above, did not individually, or when combined with other component findings, contribute to a significant deficiency at the DHS consolidated financial statement level.

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Independent Auditors' Report
Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

I-A Financial Reporting

Background: In FY 2007, we reported that the Coast Guard had several internal control weaknesses that led to a material weakness in financial reporting. In FY 2008, the Coast Guard revised its *Financial Strategy for Transformation and Audit Readiness* (FSTAR). The FSTAR is a comprehensive plan to identify and correct the root causes of control deficiencies. However, most of the actions outlined in FSTAR are scheduled to occur after FY 2008, and consequently, the Coast Guard was not able to make substantial progress in correcting the deficiencies we reported in previous years, and repeated below.

Conditions: The Coast Guard:

- Has not developed and implemented an effective general ledger system. The Core Accounting System (CAS), Aircraft Logistics Management Information System (ALMIS), and Naval Engineering Supply Support System (NESSS) general ledgers do not comply with the requirements of the *Federal Financial Management Improvement Act* (FFMIA), We noted that:
  - The general ledgers do not allow for compliance with the United States Standard General Ledger (USSGL) at the transaction level. For example, the general ledgers include non-compliant account definitions, invalid accounts, improper posting logic codes and inconsistent crosswalks to the Coast Guard *Treasury Information Executive Repository* (TIER) database;
  - The CAS general ledger includes static balances related to a legacy general ledger conversion;
  - Financial data in the general ledger may be compromised by automated and manual changes that are unsubstantiated, through the use of information technology (IT) scripts;
  - Financial information submitted to the Department for consolidation is from a database that does not maintain detail at the transaction level and is not reconciled or supported by the transaction level detail in the Coast Guard's three general ledgers; and
  - Topside adjustments necessary to close and report financial activity are not recorded at the transaction level in the respective general ledgers. Period-end and opening balances are not supported by transactional detail in the three general ledgers.
- Does not have properly designed, implemented and effective policies, procedures, and controls surrounding its financial reporting process, in order to support beginning balances, year-end close-out, and the cumulative results of operation analysis. For example, the Coast Guard does not have effective policies, procedures and / or internal controls:
  - To identify the cause and resolve system-level abnormal balances and account relationship discrepancies, e.g., budgetary to proprietary reconciliations, and identified potential errors in its financial data;
  - Over the process of preparing and reviewing adjustments to account balances and financial statement disclosures, and uses high-level analytical comparisons to identify adjusting entries;
  - To assess potential financial system problems, such as posting logic errors and automated changes to financial data through scripts (system modifications);
  - To record, review, and monitor accounts receivable activity;
  - To compile, support, review, and report financial statement disclosures submitted for incorporation in the DHS financial statements, to include the effective completion of the U.S. Government Accountability Office (GAO) Disclosure Checklist and valid support for the preparation of statement of net cost disclosures; and
  - To track and reconcile intragovernmental transactions with its Federal trading partners, especially those outside DHS, and to determine that Coast Guard intragovernmental balances, as reported in the DHS financial statements, are complete, accurate, appropriately valued, belong to the Coast Guard, and presented properly in the financial statements.

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Exhibit I – Material Weaknesses in Internal Control – U.S. Coast Guard

Cause/Effect: Some of the conditions described above are related to the conditions described in Exhibit III-G *Entity-Level Controls.* The Coast Guard has general ledger structural and IT system functionality deficiencies that make the financial reporting process more complex and difficult. The financial reporting process is overly complex, labor intensive, and requires a significant number of topside adjustments (adjustments made outside the core accounting system for presentation of financial information given to the Department for consolidation). The accuracy of financial information is highly dependent on the knowledge and experience of a limited number of key financial personnel rather than on clearly documented procedural manuals and process-flow documentation. Consequently, the Coast Guard can not be reasonably certain that its financial statements are complete or accurate at any time. In its annual Assurance Statement provided to the DHS Secretary in September 2008, the Coast Guard was unable to provide reasonable assurance that internal controls over financial reporting are operating effectively, and was unable to represent to its auditors that any significant balance sheet line items, except for investments and contingent liabilities, are fairly stated at September 30, 2008.

Criteria: FFMIA Section 803(a) requires that Federal financial management systems comply with (1) Federal accounting standards, (2) Federal system requirements, and (3) the USSGL at the transaction level. FFMIA emphasizes the need for agencies to have systems that can generate timely, reliable, and useful information with which to make informed decisions to ensure ongoing accountability.

The Federal Managers' Financial Integrity Act of 1982 (FMFIA) requires that agencies establish internal controls according to standards prescribed by the Comptroller General and specified in the GAO *Standards for Internal Control in the Federal Government (Standards).* These standards define internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are being achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

The GAO *Standards* require that internal controls be documented in management directives, administrative policies or operating manuals; transactions and other significant events be clearly documented; and information be recorded and communicated timely with those who need it within a timeframe that enables them to carry out their internal control procedures and other responsibilities.

The *Treasury Federal Intragovernmental Transactions Accounting Policies Guide,* dated August 15, 2008, and OMB Circular No. A-136, *Financial Reporting Requirements,* as revised, require Federal CFO Act and non-CFO Act entities identified in the Treasury Financial Manual (TFM) 2008, Vol. I, Part 2-Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government,* to perform quarterly reconciliations of intragovernmental activity/balances. TFM, Section 4706, *Intragovernmental Requirements,* requires reporting agencies to reconcile and confirm intragovernmental activity and balances quarterly for specific reciprocal groupings. TFM Bulletin 2007-03, *Intragovernmental Business Rules*, also provides guidance to Federal agencies for standardizing the processing and recording of intragovernmental activities.

Recommendations: We recommend that the Coast Guard:

1. Implement an integrated general ledger system that is FFMIA compliant. Until an integrated general ledger system is implemented, ensure that all financial transactions and adjustments, including top-side entries, are recorded in the proper general ledger at the detail USSGL transaction level as they occur, and all financial statement line items should be reconciled and supported by transactional detail contained in the general and subsidiary ledgers;
2. Conduct an assessment to identify and remove all non-compliant chart of account definitions, invalid and static accounts, identify any improper posting logic transaction codes, and identify inconsistencies in crosswalks to the TIER database provided to DHS OFM for consolidation;
3. Identify and evaluate each manual and automated IT script to determine the effect on the current year and prior year financial statement balances, and make adjustments in the appropriate general ledger system, as necessary;
4. Establish new or improve existing policies, procedures, and related internal controls to ensure that:

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a) The year-end close-out process, reconciliations, and financial data and account analysis procedures are supported by documentation, including evidence of effective management review and approval, and beginning balances in the following year are determined to be reliable and auditable;

b) Topside adjustments to account balances and abnormal balances and account relationship discrepancies, e.g., budgetary to proprietary reconciliations, are identified, reviewed, and documented;

c) Account reconciliations, for each of the three general ledgers and the monthly TIER submission, are performed timely each month, and differences are researched and resolved before the next month's reporting cycle. Reconciliations should include all funds maintained by the Coast Guard, including revolving, special, and trust funds;

d) All accounts receivables are identified and comprehensive Coast Guard-wide policies and procedures are implemented, including internal controls at a sufficient level of detail to determine that the accounts receivable process is effective to support management assertions, in compliance with generally accepted accounting principles, for the accounts receivable balance reported on the Coast Guard balance sheet; and

e) Financial statement disclosures submitted for incorporation in the DHS financial statements are compiled, supported, reviewed, and reported, to include the effective completion the GAO Disclosure Checklists and valid support for the preparation of the statement of net cost disclosure; and

5. Establish a formal documented review and approval process over reconciliation activities performed by Coast Guard to ensure that all intragovernmental activity and balances are identified and differences are being resolved in a timely manner in coordination with the Department's OFM. Intragovernmental balances should be reconciled to supporting detail files prior to submission to OFM.

I-B Information Technology (IT) General and Application Controls

Background: The Coast Guard maintains three general ledger systems that support its financial statements and other financial data provided to DHS OFM for consolidation, which are CAS, ALMIS, and NESSS – described in Exhibit I-A, *Financial Reporting*. Our audit included a review of the Coast Guard's IT general controls (ITGC), and specifically in six key control areas: entity-wide security program planning and management, access control, application software development and change control, system software, segregation of duties, and service continuity. During FY 2008, the Coast Guard took actions to improve aspects of its ITGC to address our prior year findings; however, the Coast Guard did not make all of the necessary improvements that they had planned to make during the year.

Conditions: During our FY 2008 ITGC testing, we identified 22 findings, of which 21 were repeat findings from prior years and one is a new finding. The ITGC and other financial system control weaknesses were identified at Coast Guard Headquarters and its components. We noted control deficiencies in three general control areas that when combined, present more than a remote possibility of materially impacting financial data integrity. The control deficiencies identified included:

- Weak security configurations and excessive access to key Coast Guard financial applications, as well as lack of review of privileged user actions;
- Application change control processes that are not adequately designed nor operating effectively; and
- Entity-wide security program deficiencies involving personnel background checks, IT security awareness training, policies and procedures for prompt employee termination, and lack of finalized certification and accreditation documentation.

The application change control process (second bullet), above is considered to be a material weakness impacting the DHS consolidated financial statements. In addition, the control deficiencies in application

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change control processes are among the principle causes of the Coast Guard's inability to support its financial statement balances. See Exhibit I-A, *Financial Reporting,* for a discussion of the related conditions causing significant noncompliance with the requirements of FFMIA. Our ITGC findings are described in greater detail in a separate *Limited Official Use* (LOU) letter provided to the Coast Guard and DHS management.

Cause/Effect: The Coast Guard has made progress correcting certain ITGC weaknesses identified in previous years. Specifically, the Coast Guard was able to close out 20 prior-year findings in the area of access controls, entity-wide security program, and service continuity. In addition, the Coast Guard has enhanced the assessment of the root cause of the ITGC weaknesses in order to effectively remediate issues; however, the Coast Guard was not able to fully implement all of its plans of action and milestones to remediate all ITGC control deficiencies in FY 2008.

Many of these weaknesses were inherited from system development activities that did not incorporate strong security controls during the initial implementation of the system more than five years ago, and will take several years to fully address. These weaknesses exist both in the documentation of processes and the implementation of adequate security controls over processes and within financial systems. Specifically, policies and procedures supporting the operation of various processes within control areas such as change control were developed without taking into account required security practices. Consequently, as policies and procedures are updated, many Coast Guard components are challenged to move away from previous methodologies and fully implement and enforce these new controls.

The effect of these ITGC weaknesses limits the Coast Guard's ability to ensure that critical financial data is reliable and is maintained in a manner to ensure confidentiality, integrity, and availability. In addition, as a result of the presence of IT weaknesses, there is added dependency on the other mitigating manual controls to be operating effectively at all times. Because mitigating controls often require more human involvement, there is an increased risk that human error could materially affect the financial statements.

Criteria: The *Federal Information Security Management Act* (FISMA), passed as part of the *Electronic Government Act of 2002,* mandates that Federal entities maintain IT security programs in accordance with National Institute of Standards and Technology (NIST) guidance.

OMB Circular No. A-130, *Management of Federal Information Resources,* describes specific essential criteria for maintaining effective general IT controls.

FFMIA sets forth legislation prescribing policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems. The purpose of FFMIA is (1) to provide for consistency of accounting by an agency from one fiscal year to the next, and uniform accounting standards throughout the Federal Government, (2) require Federal financial management systems to support full disclosure of Federal financial data, including the full costs of Federal programs and activities, (3) increase the accountability and credibility of federal financial management, (4) improve performance, productivity and efficiency of Federal Government financial management, and (5) establish financial management systems to support controlling the cost of Federal Government.

OMB Circular No. A-123, *Management's Responsibility for Internal Control,* states, "Agency managers should continuously monitor and improve the effectiveness of internal control associated with their programs. This continuous monitoring, and other periodic evaluations, should provide the basis for the agency head's annual assessment of and report on internal control, as required by FMFIA." This Circular indicates that "control weaknesses at a service organization could have a material impact on the controls of the customer organization. Therefore, management of cross-servicing agencies will need to provide an annual assurance statement to its customer agencies in advance to allow its customer agencies to rely upon that assurance statement. Management of cross-servicing agencies shall test the controls over the activities for which it performs for others on a yearly basis. These controls shall be highlighted in management's annual assurance statement that is provided to its customers [e.g., TSA]. Cross-servicing and customer agencies will need to coordinate the timing of the assurance statements."

DHS' *Sensitive Systems Policy Directive, 4300A*, as well as the DHS' *Sensitive Systems Handbook* documents policies and procedures adopted by DHS intended to improve the security and operation of all DHS IT systems including the Coast Guard IT systems.

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The GAO's *Federal Information System Controls Audit Manual* (FISCAM) provides a framework and recommended audit procedures that are used to conduct the IT general control test work.

Recommendations: We recommend that the DHS Office of Chief Information Officer in coordination with the Office of the Chief Financial Officer (OCFO) make the following improvements to the Coast Guard's financial management systems:

1. Implement the recommendations in our LOU letter provided to the Coast Guard and DHS management, to effectively address the deficiencies identified including: (1) weak security configurations and excessive access to key Coast Guard financial applications, including review of as of privileged user actions, (2) application change control processes, and (3) entity-wide security program issues;
2. Design and implement plan of action and milestones that address the root cause of the weakness; and
3. Develop and implement policies and procedures that appropriately consider required security practices when supporting the operation of various processes within the change control area.

I-C Fund Balance with Treasury

Background: In FY 2007, we reported a material weakness in Fund Balance with Treasury (FBwT) at the Coast Guard. In FY 2008, the Coast Guard revised its remediation plan (FSTAR); however, the majority of corrective actions are scheduled to occur after FY 2008, and accordingly, many of the conditions stated below are repeated from our FY 2007 report. FBwT at the Coast Guard totaled approximately $5.2 billion, or approximately 8.3 percent of total DHS FBwT, at September 30, 2008. The majority of these funds represented appropriated amounts that were obligated, but not yet disbursed, as of September 30, 2008.

Conditions: The Coast Guard has not developed and validated a comprehensive process, to include effective internal controls, to ensure that FBwT transactions exists and are complete and accurate. For example, the Coast Guard:

- Did not maintain adequate supporting documentation that validated the accuracy for five of the six Coast Guard Agency Location Codes FBwT reconciliations;
- Recorded adjustments to the general ledger FBwT accounts including adjustments to agree Coast Guard balances to Treasury amounts, that were unsupported and subsequently submitted to the Treasury;
- Does not have an effective process for clearing of suspense account transactions related to FBwT. The Coast Guard lacks documented and effective policies and procedures and internal controls necessary to support the completeness, existence, and accuracy of suspense account transactions. In addition, the Coast Guard was unable to produce complete and accurate detail listings of suspense transactions recorded in the general ledger; and
- Was unable to provide military and civilian payroll data to support the summary payroll transactions processed through the Coast Guard's FBwT. In addition, the Coast Guard lacked formal policies and procedures for processing and documenting all military and civilian payroll transactions.

Cause/Effect: The Coast Guard had not designed and implemented accounting processes, including a financial system that complies with federal financial system requirements, as defined in OMB Circular No. A-127, *Financial Management Systems*, and the requirements of the *Joint Financial Management Improvement Program* (JFMIP), now administered by the *Financial Systems Integration Office* (FSIO), to fully support the FY 2008 FBwT activity and balance as of September 30, 2008. Failure to implement timely and effective reconciliation processes could increase the risk of undetected errors and/or violations of appropriation laws, including instances of undiscovered *Anti-deficiency Act* violations or fraud, abuse and mismanagement of funds, which could lead to inaccurate financial reporting and affects DHS' ability to effectively monitor its budget status.

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Criteria: Statement of Federal Financial Accounting Standards (SFFAS) No. 1, *Accounting for Selected Assets and Liabilities,* paragraph 39 states, "Federal entities should explain any discrepancies between fund balance with Treasury in their general ledger accounts and the balance in the Treasury's accounts and explain the causes of the discrepancies in footnotes to the financial statements. (Discrepancies due to time lag should be reconciled and discrepancies due to error should be corrected when financial reports are prepared). Agencies also should provide information on unused funds in expired appropriations that are returned to Treasury at the end of a fiscal year."

Per *Fund Balance with Treasury Reconciliation Procedures, a Supplement to the I TFM 2-5100*, Section V, "Federal agencies must reconcile their SGL 1010 account and any related subaccounts [...] on a monthly basis (at minimum). [...] Federal agencies must [...] resolve all differences between the balances reported on their G/L FBwT accounts and balances reported on the [*Government-wide Accounting* system (GWA)]." In addition, "An agency may not arbitrarily adjust its FBWT account. Only after clearly establishing the causes of errors and properly documenting those errors, should an agency adjust its FBWT account balance. If an agency must make material adjustments, the agency must maintain supporting documentation. This will allow correct interpretation of the error and its corresponding adjustment."

Section 803(a) of FFMIA requires that Federal financial management systems comply with (1) Federal accounting standards, (2) Federal financial management system requirements, and (3) the USSGL at the transaction level. FFMIA emphasizes the need for agencies to have systems that can generate timely, reliable, and useful information with which to make informed decisions to ensure ongoing accountability.

The GAO *Standards* hold that transactions should be properly authorized, documented, and recorded accurately and timely.

Recommendations: We recommend that the Coast Guard:

1. Establish policies, procedures, and internal controls to ensure that FBwT transactions are recorded accurately and completely and in a timely manner, and that all supporting documentation is maintained for all recorded transactions. These policies and procedures should allow the Coast Guard to:
   a) Perform complete and timely FBwT reconciliations using the Treasury Government-wide Accounting tools;
   b) Better manage its suspense accounts to include researching and clearing items carried in suspense clearing accounts in a timely manner during the year, and maintaining proper supporting documentation in clearing suspense activity; and
   c) Maintain payroll data supporting payroll transactions processed through FBwT and have access to complete documentation, if needed.

I-D Capital Assets and Supplies

Background: The Coast Guard maintains approximately 59 percent of all DHS property, plant, and equipment (PP&E), including a large fleet of boats and vessels. Many of the Coast Guard's assets are constructed over a multi-year period, have long useful lives, and undergo extensive routine servicing that may increase their value or extend their useful lives. In FY 2008, the Coast Guard revised corrective action plans (FSTAR) to address the PP&E process and control deficiencies, and began remediation efforts. However, the FSTAR is scheduled to occur over a multi-year time-frame. Consequently, most of the conditions cited below have been repeated from our FY 2007 report.

Operating Materials and Supplies (OM&S) are maintained by the Coast Guard in significant quantities and consist of tangible personal property to be consumed in normal operations to service marine equipment, aircraft, and other operating equipment. The majority of the Coast Guard's OM&S is physically located at either two Inventory Control Points (ICPs) or in the field. The Coast Guard's policy requires regularly scheduled physical counts of OM&S, which are important to the proper valuation of OM&S and its safekeeping. The conditions cited below for OM&S have been repeated from our FY 2007 report.

Conditions: The Coast Guard has not:

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Regarding PP&E:

- Consistently applied policies and procedures to ensure appropriate documentation supporting PP&E acquisitions, and their existence, is maintained to support capitalized PP&E. In cases where original acquisition documentation has not been maintained, the Coast Guard has not developed and documented methodologies and assumptions to support the value of PP&E;
- Implemented appropriate controls and related processes to accurately, consistently, and timely record additions to PP&E and construction in process (CIP), transfers from other agencies, disposals in its fixed asset system, and valuation and classification of repairable PP&E;
- Implemented accurate and complete asset identification, system mapping, and tagging processes that include sufficient detail, e.g., serial number, to clearly differentiate and accurately track physical assets to those recorded in the fixed asset system; and
- Properly accounted for some improvements and impairments to buildings and structures, capital leases, and selected useful lives for depreciation purposes, consistent with generally accepted accounting principles (GAAP).

Regarding OM&S:

- Implemented policies, procedures, and internal controls to support the completeness, accuracy, existence, valuation, ownership, and presentation assertions related to the FY 2008 OM&S and related account balances;
- Fully designed and implemented policies, procedures, and internal controls over physical counts of OM&S to remediate conditions identified in previous years;
- Properly identified (bar-coded or tagged) recorded OM&S; and
- Established processes and controls to fully support the calculated value of certain types of OM&S to approximate historical cost.

Cause/Effect: PP&E policies and procedures are not appropriately designed, consistently followed, or do not include sufficient controls to ensure compliance with policy or to ensure complete supporting documentation is maintained and readily-available. The fixed asset module of the Coast Guard's CAS is not updated for effective tracking and reporting of PP&E. As a result, the Coast Guard is unable to accurately account for its PP&E, and provide necessary information to DHS OFM for consolidated financial statement purposes.

Coast Guard management deferred correction of most OM&S weaknesses reported in previous years, and acknowledged that the conditions we reported in prior years remained throughout FY 2008. Lack of comprehensive and effective policies and controls over the performance of physical counts, and appropriate support for valuation, may result in errors in the physical inventory process or inventory discrepancies that could result in financial statement misstatements.

Criteria: SFFAS No. 6, *Accounting for Property, Plant, and Equipment,* provides the general requirements for recording and depreciating property, plant and equipment.

The Federal Accounting Standards Advisory Board (FASAB)'s Federal Financial Account Standards Interpretation No. 7, dated March 16, 2007, defines "items held for remanufacture" as items "in the process of (or awaiting) inspection, disassembly, evaluation, cleaning, rebuilding, refurbishing and/or restoration to serviceable or technologically updated/upgraded condition. Items held for remanufacture may consist of: Direct materials, (including repairable parts or subassemblies [...]) and Work-in-process (including labor costs) related to the process of major overhaul, where products are restored to 'good-as-new' condition and/or improved/upgraded condition. 'Items held for remanufacture' share characteristics with 'items held for repair' and items in the process of production and may be aggregated with either class. Management should use judgment to determine a reasonable, consistent, and cost-effective manner to classify processes as 'repair' or 'remanufacture'."

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FFMIA Section 803(a) requires each agency to implement and maintain a system that complies substantially with Federal financial management system requirements. OMB Circular No. A-127 prescribes the standards for federal agencies' financial management systems. That Circular requires an agency's system design to have certain characteristics that include consistent "internal controls over data entry, transaction processing, and reporting throughout the system to ensure the validity of the information and protection of Federal Government resources."

According to GAO *Standards for Internal Control in the Federal Government*, assets at risk of loss or unauthorized use should be periodically counted and compared to control records. Policies and procedures should be in place for this process. The FSIO publication, *Inventory, Supplies, and Material System Requirements,* states that "the general requirements for control of inventory, supplies and materials consist of the processes of receipt and inspection, storing, and item in transit." Specifically, the "placement into inventory process" requires that an agency's inventory, supplies and materials system must identify the intended location of the item and track its movement from the point of initial receipt to its final destination." SFFAS No. 3, *Accounting for Inventory and Related Property*, states OM&S shall be valued on the basis of historical cost.

Recommendations: We recommend that the Coast Guard:

Regarding PP&E:

1. Improve controls and related processes and procedures to ensure that documentation supporting existing PP&E acquisitions, additions, transfers, and disposals, to include the CIP process, is maintained to support capitalized PP&E;
2. Implement processes and controls to record PP&E transactions accurately, consistently, and timely in the fixed asset system; record an identifying number in the fixed asset system at the time of asset purchase to facilitate identification and tracking; and ensure that the status of assets is accurately maintained in the system;
3. Revise procedures for performing physical inventories of repairable items, to include procedures for resolving differences and reporting results, to ensure that repairable PP&E is accurately and completely classified and recorded. Support the pricing methodology used to value repairable PP&E to ensure that balances, as presented in the financial statements, approximate amortized historical cost; and
4. Review policies and procedures to account for improvements and impairments to buildings and structures, capital leases, and identify proper useful lives for depreciation purposes in accordance with GAAP.

Regarding OM&S:

5. Update OM&S physical count policies, procedures, and controls, and provide training to personnel responsible for conducting physical inventories, and include key elements of an effective physical inventory in the policies;
6. Consider adopting an inventory control system for OM&S as a method of tracking usage and maintaining a perpetual inventory of OM&S on hand; and
7. Establish processes and controls to support the calculated value of OM&S to ensure accounting is consistent with GAAP.

I-E Actuarial and Other Liabilities

Background: The Coast Guard maintains pension, medical, and post employment travel benefit programs that require actuarial computations to record related liabilities for financial reporting purposes. The Military Retirement System (MRS) is a defined benefit plan that covers both retirement pay and health care benefits for all active duty and reserve military members of the Coast Guard. The medical plan covers active duty, reservists, retirees/survivors and their dependents that are provided care at Department of Defense (DoD) medical facilities. The post employment travel benefit program pays the cost of

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transportation for uniformed service members upon separation from the Coast Guard. Annually, participant and cost data is extracted by the Coast Guard from its records and provided to an actuarial firm as input for the liability calculations. The accuracy of the actuarial liability as reported in the financial statements is dependent on the accuracy and completeness of the underlying participant and cost data provided to the actuary as well as the reasonableness of the assumptions used. A combined unfunded accrued liability of approximately $30.1 billion for the plans is reported in the DHS consolidated balance sheet as of September 30, 2008.

The Coast Guard estimates accounts payable as a percentage of undelivered orders (UDOs) based on historical trends. As described in Exhibit I-F, *Budgetary Accounting*, reliable accounting processes surrounding the recording of obligations and disbursements, and tracking of UDOs, are key to the accurate reporting of accounts payable in the Coast Guard's financial statements.

The Coast Guard's environmental liabilities consist of two main types: shore facilities and vessels. Shore facilities include any facilities or property other than ships, e.g., buildings, fuel tanks, lighthouses, small arms firing ranges (SAFRs), etc.

The Coast Guard estimates its legal liabilities to include Oil Spill Liability Trust Fund claims that are incorporated, and recorded, as part of the DHS legal liability on DHS financial statements.

Conditions: We noted the following internal control weaknesses related to actuarial and other liabilities. The Coast Guard does not:

- Have effective policies, procedures, and controls to ensure the completeness and accuracy of participant data, medical cost data, and trend and experience data provided to, and used by, the actuary for the calculation of the MRS pension, medical, and post employment benefit liabilities. Reconciliations between subsidiary and general ledger amounts for medical expenditures are not effective;

- Have effective policies, procedures and internal controls over the Coast Guard's process for reconciling military payroll recorded in the CAS general ledger to detail payroll records. Military personnel data changes, including changes in leave balances and payroll corrections, are not processed in the appropriate payroll and/or reporting periods, and consequently impact the completeness and accuracy of leave and payroll accruals as well as data used for actuarial projections;

- Use a reliable methodology to estimate accounts payable. The method used was not supported as to the validity of data, assumptions, and criteria used to develop and subsequently validate the reliability of the estimate for financial reporting; and

- Support the completeness, existence, and accuracy assertions of the data utilized in developing the estimate for the FY 2008 environmental liability account balance. The Coast Guard has not fully developed, documented, and implemented the policies and procedures in developing, preparing, and recording the environmental liability estimates related to shore facilities, and has not approved policies and procedures for the review of the environmental liability estimate related to vessels.

Cause/Effect: Much of the data required by the actuary comes from personnel and payroll systems that are outside of the Coast Guard's accounting organization and are instead managed by the Coast Guard's Personnel Service Center (PSC). The Coast Guard has not updated its experience study since 2006, which contained several errors, and therefore, management is unable to provide assurance on the completeness and accuracy of the experience study which affects the completeness and accuracy of actuarially determined liabilities as stated in the DHS consolidated balance sheet at September 30, 2008. In addition, the Coast Guard does not have sufficient controls to prevent overpayments for medical services. Thus, inaccurate medical costs submitted to the Coast Guard actuary could result in a misstatement of the actuarial medical liability and related expenses.

The Coast Guard has not yet developed comprehensive policies and procedures or corrective action plans to address the conditions above, and consequently, management is unable to assert to the accuracy and completeness of the accounts payable and payroll accruals recorded as of September 30, 2008.

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Criteria: According to SFFAS No. 5, *Accounting for Liabilities of the Federal Government,* paragraph 95, the employer should recognize an expense and a liability for other post employment benefits (OPEB) when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the reporting date. Further, the long-term OPEB liability should be measured at the present value of future payments, which requires the employer to estimate the amount and timing of future payments, and to discount the future outflow over the period for which the payments are to be made.

The GAO *Standards* hold that transactions should be properly authorized, documented, and recorded accurately and timely. SFFAS No. 1 states, "When an entity accepts title to goods, whether the goods are delivered or in transit, the entity should recognize a liability for the unpaid amount of the goods. If invoices for those goods are not available when financial statements are prepared, the amounts owed should be estimated."

Statement on Auditing Standards (SAS) No. 57, *Auditing Accounting Estimates,* states "An entity's internal control may reduce the likelihood of material misstatements of accounting estimates." The standard specifically identifies, "accumulation of relevant, sufficient, and reliable data on which to base an accounting estimate," and "comparison of prior accounting estimates with subsequent results to assess the reliability of the process used to develop estimates" as two relevant aspects of internal control.

Federal Accounting Standards Advisory Board (FASAB) Technical Release No. 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government,* states that an agency is required to recognize a liability for environmental cleanup costs as a result of past transactions or events when a future outflow or other sacrifice of resources is probable and reasonably estimable. Probable is related to whether a future outflow will be required. Reasonably estimable relates to the ability to reliably quantify in monetary terms the outflow of resources that will be required.

Recommendations: We recommend that the Coast Guard:

Regarding actuarial liabilities:

1. Establish and document policies, procedures, and effective controls to ensure the completeness and accuracy of the actuarial pension, medical, and post employment travel benefit liabilities;
2. Establish and document policies, procedures, and effective controls to ensure the completeness and accuracy of participant data, medical cost data, and trend and experience data provided to, and used by, the actuary for the calculation of the MRS pension, medical, and post employment travel benefit liabilities; and
3. Perform a periodic reconciliation between the medical expenditures recorded in the subsidiary ledger and those recorded in the CAS, and address differences before data is provided to the actuary. This reconciliation should be performed for all significant sources of medical actuarial data, including TriCare, and DoD Military Treatment Facilities (MTFs). In addition, this reconciliation should be reviewed by someone other than the preparer to ensure accuracy.

Regarding accounts payable and payroll:

4. Analyze and make appropriate improvements to the methodology used to estimate accounts payable and support all assumptions and criteria with appropriate documentation to develop and subsequently validate the estimate for financial reporting; and
5. Implement corrective action, including appropriately designed and implemented internal controls, to support the completeness, existence, and accuracy of changes in member personnel data records and military payroll transactions, and to include recorded accrued military leave and payroll liabilities.

Regarding environmental liabilities:

6. Develop consistent written agency-wide policies, procedures, processes, and controls to ensure identification of and recording of all environmental liabilities, define the technical approach, cost estimation methodology, and overall financial management oversight of its environmental remediation projects. The policies should include:

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a) Procedures to ensure the proper calculation and review of cost estimates for consistency and accuracy in financial reporting, including the use of tested modeling techniques, use of verified cost parameters, and assumptions;

b) Periodically validate estimates against historical costs; and

c) Ensure that detailed cost data is maintained and reconciled to the general ledger.

I-F Budgetary Accounting

Background: Budgetary accounts are a category of general ledger accounts where transactions related to the receipt, obligation, and disbursement of appropriations and other authorities to obligate and spend agency resources are recorded. Each Treasury Account Fund Symbol (TAFS) with separate budgetary accounts must be maintained in accordance with OMB and Treasury guidance. The Coast Guard has over 90 TAFS covering a broad spectrum of budget authority, including annual, multi-year, and no-year appropriations; and several revolving, special, and trust funds. In addition, the Coast Guard estimates accounts payable at year end as a percentage of UDOs based on historical trends. Reliable accounting processes surrounding obligations, UDOs and disbursements are key to the accurate reporting of accounts payable in the DHS consolidated financial statements.

Conditions: We noted the following internal control weaknesses related to budgetary accounting, many of which were repeated from our FY 2007 report.

- The policies, procedures and internal controls over the Coast Guard's process for validation and verification of UDO balances are not effective to ensure that recorded obligations and UDO balances were complete, valid, accurate, and that proper approvals and supporting documentation is maintained.
- Procedures used to record commitment/obligations and internal controls within the process have weaknesses that could result in obligations of funds in excess of the apportioned and/or allotted amounts. In addition, the Coast Guard has not fully implemented current policies and procedures to monitor un-obligated commitment activity in CAS throughout the fiscal year as only a de-commitment process is executed at year end.
- The Coast Guard's procedures, processes, and internal controls in place to verify the completeness and accuracy of the year-end obligation pipeline adjustment to record all executed obligations were not properly designed and implemented. These deficiencies affected the completeness, existence, and accuracy of the year-end "pipeline" adjustment that was made to record obligations executed before year end.
- Automated system controls are not effectively used to prevent the processing of procurement transactions by an individual who does not have warrant authority, or by contracting officer's with expired warrant authority.

Cause/Effect: Several of the Coast Guard's budgetary control weaknesses can be corrected by modifications or improvements to the financial accounting system, process improvements, and strengthened policies and internal controls. Weak controls in budgetary accounting, and associated contracting practices increase the risk that the Coast Guard could violate the *Anti-deficiency Act* and overspend its budget authority. The financial statements are also at greater risk of misstatement. The untimely release of commitments may prevent funds from being used timely for other purposes.

Criteria: According to the Office of Federal Financial Management's *Core Financial System Requirements*, dated January 2006, an agency's core financial management system must ensure that an agency does not obligate or disburse funds in excess of those appropriated or authorized, and "the Budgetary Resource Management Function must support agency policies on internal funds allocation methods and controls." The *Federal Acquisition Regulation* (FAR) Section 1.602 addresses the authorities and responsibilities granted to contracting officers. Treasury's USSGL guidance at TFM S2 08-03 (dated August 2008) specifies the accounting entries related to budgetary transactions.

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FFMIA Section 803(a) requires that each Agency implement and maintain a system that complies substantially with Federal financial management system requirements. OMB Circular No. A-127 sets forth the standards for federal financial management systems.

Recommendations: We recommend that the Coast Guard:

1. Improve policies, procedures, and the design and effectiveness of controls related to processing obligation transactions, including periodic review and validation of UDOs. Emphasize to all fund managers the need to perform effective reviews of open obligations, obtain proper approvals, and retain supporting documentation;
2. Revise controls and related policies and procedures to periodically review commitments;
3. Improve procedures, processes, and internal controls to verify the completeness and accuracy of the year-end obligation pipeline adjustment to record all executed obligations for financial reporting; and
4. Establish automated system controls to prevent incurring a commitment/obligation in excess of established targets so that funds are not obligated in excess of the apportioned and allotted amounts and preclude the processing of procurement transactions if the contracting officer's warrant authority had expired.

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II-A Financial Reporting (TSA and FEMA)

	2008	2007	2006
DHS-HQ	C	MW	MW
FEMA	MW	MW	
TSA	MW	SD	MW

Key – Trend Table	
C	Corrected
SD	Significant Deficiency*
MW	Material Weakness*
* See Introduction	

Background: Since 2006, the Transportation Security Administration (TSA) has had difficulty establishing baseline accounting policies, procedures, and processes, with well-designed and effective internal controls. The transition to the Coast Guard's *Core Accounting System* (CAS) for its primary general ledger required the development and implementation of many new accounting processes and procedures, some of which were needed to mitigate information technology (IT) general control weaknesses that currently exist in CAS. In FY 2007, TSA adopted a two-year corrective action plan to address its financial reporting and other accounting internal control weaknesses, and progress has been made in correcting some material weaknesses identified in FY 2007. In addition, since FY 2006, TSA has made progress in building its financial reporting infrastructure and ability to support account balances. However, audit procedures performed by us identified additional and more serious financial reporting control weaknesses, some of which have existed since the agency's inception. As a result, TSA management was unable to assert that the entire balance sheet is fairly stated in compliance with generally accepted accounting principles (GAAP). In addition, we are now reporting weaknesses in entity-level controls at TSA (See Comment III-G, *Entity Level Controls*).

The Federal Emergency Management Agency (FEMA)'s accounting and financial reporting processes must support multi-faceted operations such as temporary assistance funds, disaster relief loans, national flood insurance programs, stockpiles of essential supplies, mission assignments to other federal agencies for restoration and reconstruction, and grants to state and local governments. These programs are sometimes subject to complicated accounting rules, as defined by the Federal Accounting Standards Advisory Board (FASAB), and require specialized technical knowledge to interpret and apply. In addition, FEMA's accounting personnel and IT systems need to be ready to mobilize and support disaster operations with little advance notice, while also maintaining effective internal controls over financial reporting. In FY 2008, FEMA made substantial progress toward correcting three material weaknesses we reported in FY 2007 and was able to assert to the completeness and accuracy of all financial statement balances except capital assets. While FEMA has taken positive steps in FY 2008, financial reporting control deficiencies existed throughout the year that, in aggregate, are considered a material weakness.

In FY 2008, the Department of Homeland Security (DHS or the Department) Headquarters (HQ) corrected its material weakness over financial reporting.

Conditions: We noted the following internal control weaknesses related to financial reporting at TSA and FEMA:

1. TSA:

   - Has not always followed policies and procedures that require supervisory reviews of financial statements and supporting documentation, and supervisory reviews performed have not been effective in identifying some material errors in the financial statements. For example TSA:
     - Routinely prepares the Government Accountability Office (GAO) accounting and disclosure checklists (FAM 2010 and 2020), as required by the Department; however, the completion of the checklists was not effective in identifying material errors in accounting for and presentation of property, plant and equipment. Consequently, TSA and the Department recorded restatements totaling more than $400 million to it FY 2007 financial statements in FY 2008 (see below and Comment II-D, *Capital Assets and Supplies*); and
     - Did not properly review and support 4 out of 27 journal vouchers sampled. Three out of the four exceptions resulted in incorrect postings to the general ledger.

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- Places inappropriate reliance on the audit as a control over financial reporting. Audit tests performed by the financial statement auditor routinely identify incomplete analysis and documentation of account balance reconciliations, which have lead to the discovery of errors in financial reporting by the auditor;
- Does not have effective procedures over the review and approval of accounting data provided to and/or received from contractors or outside specialists retained by TSA to support the financial statement audit. For example:
  - Data used in computation of the year-end accounts payable accrual was inaccurate, resulting in an erroneous reported balance; and
  - Information prepared by subcontractors supporting material adjustments made to the financial statements was not adequately reviewed by management before it was provided to the auditor.
- Has not developed and implemented procedures to fully analyze the effects of its current and newly adopted accounting policies to ensure full compliance with GAAP. For example, TSA:
  - Modified its capitalization threshold twice in FY 2008 in response to auditor inquiries regarding the appropriateness of the dollar threshold;
  - Restated its FY 2007 financial statements to correct an understatement of property, plant and equipment totaling approximately $87 million, caused by adopting a capitalization threshold that was determined to be too high; and
  - Did not perform an analysis of contingent liabilities that could aggregate to a material liability prior to the auditor's inquiry.
- Did not fully reconcile its intragovernmental balances with trading partners. For example, TSA:
  - Did not confirm its reporting, or identify the cause of the difference, with the Department of Transportation in the Material Differences Report for the third quarter; and
  - Reported in its CFO Certification form sent to DHS Office of Financial Management (OFM) that TSA was unable to fully identify and present its intragovernmental balances and transactions by trading partner as of June 30, 2008, and therefore was unable to provide supporting documentation to OFM as requested.

2. FEMA:

- Does not have a sufficient number of experienced financial managers and staff to address non-routine accounting issues timely. A lack of skilled accounting resources has contributed to FEMA's inability to perform important accounting functions timely throughout FY 2008. For example, we noted that FEMA:
  - Did not prepare and record adjustments for its National Flood Insurance Program (NFIP) accurately. Several errors were identified after submission of FEMA's interim financial information to OFM. In addition, certain of these journal entries were recorded in the general ledger prior to final review and approval of the supporting documentation; and
  - Did not establish an accounts payable accrual for certain outstanding obligations, and did not validate a supportable estimate of accounts payable throughout the year for certain other outstanding obligations, requiring a change in methodology in early October to ensure proper year-end reporting.
- Lacks segregation of duties in financial reporting roles, and consequently does not have sufficient supervisory review processes over all material accounts. For example, we identified an error in accounting for undelivered orders totaling approximately $1.5 billion, where the balance was not adequately reviewed and approved by a second supervisory level person.
- Did not fully reconcile its intragovernmental balances with trading partners. Differences related to FEMA's transactions and balances were identified in the Department of the Treasury's Material

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Differences Report for the first three quarters of the fiscal year. In some cases, FEMA could not confirm or support reported balances or identify the reason for the differences.

Cause/Effect: TSA's corrective action plans, initiated in FY 2007, did not project full remediation of control deficiencies until FY 2009. Further, it was necessary for TSA to defer certain corrective actions to devote more resources to its review and correction of errors discovered in capital asset balances during FY 2008. Material errors discovered by the outside auditor are an indicator of continued material weaknesses in internal control over financial reporting. TSA's service provider could not provide the breakout of intragovernmental activity by trading partner.

FEMA maintains a relatively small headquarters financial and accounting staff compared to its diverse programmatic and mission focused objectives, and has experienced high turn-over in financial management and accounting personnel in FY 2008. FEMA also committed substantial human and financial resources to reconcile and correct potential errors in account balances that contributed to qualifications of our FY 2007 Independent Auditors' Report. As a result, sufficient resources were not available to fully address control deficiencies in other areas.

Criteria: Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control,* defines management's responsibility for internal control and provides guidance to Federal managers on improving the accountability and effectiveness of Federal programs and operations by establishing, assessing, correcting, and reporting on internal control. Within the organizational structure, management must clearly: define areas of authority and responsibility; appropriately delegate the authority and responsibility throughout the agency; establish a suitable hierarchy for reporting; support appropriate human capital policies for hiring, training, evaluating, counseling, advancing, compensating, and disciplining personnel; and uphold the need for personnel to possess and maintain the proper knowledge and skills to perform their assigned duties as well as understand the importance of maintaining effective internal control within the organization.

OMB Circular No. A-50, *Audit Follow-Up,* states that corrective action taken by management on resolved findings and recommendations is essential to improving the effectiveness and efficiency of Government operations. Each agency shall establish systems to assure the prompt and proper resolution and implementation of audit recommendations. These systems shall provide for a complete record of action taken on both monetary and nonmonetary findings and recommendations.

The *Treasury Federal Intragovernmental Transactions Accounting Policies Guide,* dated August 15, 2008, and OMB Circular No. A-136, *Financial Reporting Requirements,* as revised, require Federal CFO Act and non-CFO Act entities identified in the Treasury Financial Manual (TFM) 2008, Vol. I, Part 2-Chapter 4700, *Agency Reporting Requirements for the Financial Report of the United States Government,* to perform quarterly reconciliations of intragovernmental activity/balances. TFM, Section 4706, *Intragovernmental Requirements,* requires reporting agencies to reconcile and confirm intragovernmental activity and balances quarterly for specific reciprocal groupings. TFM Bulletin 2007-03, *Intragovernmental Business Rules*, also provides guidance to Federal agencies for standardizing the processing and recording of intragovernmental activities.

Recommendations: We recommend that:

1. TSA:
   a) Adhere to established policies and procedures requiring supervisory review of financial information, supporting documentation, and account balance reconciliations, to ensure that all material errors in the financial statements are identified and corrected timely.
   b) Develop and implement policies and procedures to:
      i) Require supervisory reviews of accounting transactions (particularly non-routine transactions), and accounting data provided to and received from contractors and outside specialists, and adequately supervise and review work performed by accounting staff and contractors;

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ii) Analyze changes in accounting policy prior to their implementation, including steps to determine whether the implementation would result in a non-compliance with GAAP;

iii) Assign documented accountability for supervisory reviews; and

iv) Eliminate reliance on the outside auditor as a control over the accuracy and completeness of financial statements, and the sufficiency of account level reconciliations.

c) Work with its accounting service provider to ensure that the proper trading partner code is recorded for each intragovernmental transaction. Until such time, TSA should consistently perform its manual process for the timely identification and reporting of trading partners for intragovernmental activities and balances.

2. FEMA:

a) Evaluate the effect of its FY 2008 reorganization in the Office of the Chief Financial Officer (OCFO) to ensure that current positions are filled with personnel with the requisite skills, and abilities necessary to ensure that important accounting functions, including non-routine and complex transactions, are addressed and accurately accounted for in the general ledger timely;

b) Establish clear management oversight responsibilities and processes to effectively review NFIP journal vouchers;

c) Assign accounting functions and responsibilities of accounting staff to ensure proper segregation of duties and supervisory reviews of material transactions and account balance reconciliations; and

d) Develop and implement procedures to properly research and reconcile its intragovernmental balances to supporting schedules and to trading partners.

II-B Information Technology General and Application Controls

Background: IT general and application controls are essential to achieving effective, reliable reporting of financial and performance data. Effective IT general controls are typically defined by the GAO's *Federal Information System Controls Audit Manual* (FISCAM) in six key control areas: entity-wide security program planning and management, access control, application software development and change control, system software, segregation of duties, and service continuity. In addition to IT general controls, financial systems contain application controls, which are the structure, policies, and procedures that apply to use, operability, interface, edit and monitoring controls of an application.

During FY 2008, DHS civilian components made progress in strengthening its IT general controls, which resulted in the closure of more than 40% of our prior year IT control findings. Additionally, some DHS components reduced the severity of the weaknesses when compared to findings reporting in the prior year.

Conditions: The FISCAM IT general and application control areas that continue to present a risk to financial systems data integrity include:

- Excessive access to key DHS financial applications, including weaknesses in access documentation and approval, disabling account access upon termination, instances of inadequate or weak passwords, configuration of workstations, servers, or network devices without necessary computer software patches, inactivity time-outs, and up-to-date anti-virus software.

- Application change control processes that are inappropriate, not fully defined, followed, or effective, including instances where changes made to the system were not always properly approved, tested, documented, or performed through System Change Requests (SCRs); instances where policies and procedures regarding change controls were not in place to prevent users from having concurrent access to the development, test, and production environments of the system, or for restricting access to application system software and system support files; and policies and procedures surrounding the system development life cycle (SDLC) process that have not been documented or finalized.

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- Service continuity issues impacting DHS' ability to ensure that DHS financial data is available when needed, including instances where the Continuity of Operations Plan (COOP) did not include an accurate listing of critical information technology systems, did not have critical data files, and an alternate processing facility was not adequately tested and documented, and various weaknesses identified in alternate processing sites.

Our findings, including significant deficiencies that do not rise to the level of being a material weakness, are described in greater detail in a separate *Limited Official Use* letter provided to DHS' Office of Inspector General (OIG) and management.

Cause/Effect: Many of these weaknesses were inherited from the legacy agencies that came into DHS, or system development activities that did not incorporate strong general computer controls from the outset and will take several years to fully address. A contributing cause to repeated findings is that DHS lacks an effective component-wide prioritization of IT systems issues, including the development of a stable centralized IT platform for the Department. When weaknesses in controls or processes are identified, the corrective actions address the symptom of the problem and do not always correct the root cause – amounting to a temporary fix. The time and resources needed to implement corrective actions necessary to mitigate the weaknesses often take multiple years.

The conditions supporting our findings collectively limit DHS' ability to ensure that critical financial and operational data is kept secure and is maintained in a manner to protect confidentiality, integrity, and availability. Many of these weaknesses, especially those in the area of change controls, may result in material errors in DHS' financial data that are not detected in a timely manner in the normal course of business. In addition, as a result of the presence of IT weaknesses, there is added pressure on the other mitigating manual controls to be operating effectively at all times. Because mitigating controls often require more human involvement, there is an increased risk of human error that could materially affect the financial statements.

Criteria: The *Federal Information Security Management Act* (FISMA) passed as part of the *E-Government Act of 2002,* mandates that Federal entities maintain IT security programs in accordance with National Institute of Standards and Technology (NIST) guidance.

OMB Circular No. A-130, *Management of Federal Information Resources,* describes specific essential criteria for maintaining effective general IT controls.

The Federal Financial Management Improvement Act (FFMIA) set forth legislation prescribing policies and standards for executive departments and agencies to follow in developing, operating, evaluating, and reporting on financial management systems. The purpose of FFMIA is: (1) to provide for consistency of accounting by an agency from one fiscal year to the next, and uniform accounting standards throughout the Federal Government; (2) require Federal financial management systems to support full disclosure of Federal financial data, including the full costs of Federal programs and activities; (3) increase the accountability and credibility of federal financial management; (4) improve performance, productivity and efficiency of Federal Government financial management; and (5) establish financial management systems to support controlling the cost of Federal Government.

DHS' *Sensitive Systems Policy, 4300A*, documents policies and procedures adopted by DHS intended to improve the security and operation of all DHS IT systems.

The FISCAM provides a framework and recommended audit procedures that are used to conduct the IT general and application control test work on financial information systems.

Recommendations: We recommend that the DHS Office of the Chief Information Officer, in coordination with the Office of the Chief Financial Officer (OCFO), make the recommended improvements to the Department's financial management systems in FY 2009. Specific recommendations are provided in a separate *Limited Official Use* letter provided to DHS management.

II-C Not Used

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II-D Capital Assets and Supplies (FEMA, TSA, and CBP)

	2008	2007	2006
CBP	SD		
FEMA	MW	MW	
TSA	MW	SD	MW
US-Visit	C	SD	MW

Background: FEMA has several internal use software programs that were either in development or in operation during FY 2008. In FY 2008, in response to auditor inquiries, FEMA initiated a review of its internal use software costs, but did not complete the analysis before DHS completed its FY 2008 Annual Financial Report (AFR). Consequently, FEMA was unable to assert that its capital asset balances, related to internal use software, are fairly stated at September 30, 2008.

In FY 2008, FEMA substantially corrected its control deficiencies over stockpile inventory.

TSA manages baggage X-ray, explosive, screening, and other equipment as part of its business. This equipment, in every major U.S. airport, is owned and maintained by TSA. The processes required to procure, ship, temporarily store, install, operate, and maintain this equipment are substantial, and consume a large portion of TSA's annual operating budget. Unique accounting processes and systems are necessary to track the status and accumulate costs, and to accurately value, account for, and depreciate the equipment. In FY 2008, in response to auditor inquires, TSA initiated various reviews of its capital assets and identified errors in its accounting for equipment used in airports that required a number of restatements to the FY 2007 financial statement balances, and current year corrections. These conditions also prevented TSA from asserting that its capital asset balances at September 30, 2008 are fairly stated prior to the completion of the DHS FY 2008 AFR.

The Customs and Border Protection (CBP)'s Secure Border Initiative (SBI) is a comprehensive multi-year plan to secure America's borders and reduce illegal immigration. The primary step in fulfilling this plan is to construct a fence along the border of the U.S. and Mexico. This fence will take many forms (i.e., physical, virtual, etc.) depending on the terrain of the land. Much of the physical fence will be constructed of steel, which has been purchased in bulk by CBP. Once a construction project is completed, the costs in construction-in-progress (CIP) are moved to Property, Plant, and Equipment (PP&E). As the SBI initiative is not part of CBP's normal course of business, CBP did not timely implement processes to record these transactions properly.

In FY 2008, US-Visit corrected its control deficiency over internal use software.

Conditions: We noted the following internal control weaknesses related to capital assets and supplies at FEMA, TSA, and CBP:

1. FEMA:

   - Does not have sufficient policies and procedures to routinely account for costs incurred to develop internal use software consistent with GAAP. For example, FEMA:
     - Did not record estimated or actual amounts for several internal use software programs under development in FY 2008, and alternatively, did not assess that the related capitalizable amounts were immaterial;
     - Has historically recorded an estimate of the capitalizable costs of internal use software on an annual basis, instead of the actual costs incurred;
     - Does not have policies and procedures to periodically assess the reliability of the internal use software estimates recorded, such as a comparison of estimates to actual costs;
     - Did not record internal use software in a separate account from internal use software in development as required by the United States Standard General Ledger (USSGL); and
     - Did not consistently begin amortization of software costs when the asset was placed in service.
   - Does not have adequate policies and procedures to accurately identify and account for the various stages of software development costs that would enable FEMA to identify the costs that should be capitalized and those that should be expensed as incurred.

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2. TSA:

- Does not have policies and procedures in place to properly account for and report equipment and internal use software balances. For example, TSA did not:
  - Perform a periodic analysis of idle assets stored in a warehouse and adjust the carrying value of those assets to net realizable value (NRV), if necessary, as required by GAAP. TSA recorded an adjustment totaling $95.9 million to properly present idle assets at NRV in the FY 2008 financial statements, of which $1.6 million was to restate its FY 2007 financial statements;
  - Identify and properly account for other direct costs incurred to transport, store, and install screening equipment at airports. TSA recorded an adjustment totaling $108.5 million to restate its FY 2007 financial statements to correct this error;
  - Identify and account for software developed for internal use in compliance with the requirements of GAAP, since the inception of the Agency in 2002. TSA recorded an adjustment totaling $260.6 million in FY 2008, of which $212.9 million was a restatement of its FY 2007 financial statements to correct this error; and
  - Depreciate some of its screening equipment using appropriate useful lives. TSA recorded an adjustment totaling $ 28.6 million in FY 2008, of which $17.3 million was a restatement of its FY 2007 financial statements to correct for this error.
- Did not adopt an appropriate asset capitalization dollar threshold, (where asset purchases above a certain dollar value are capitalized, and below which are expensed). The dollar threshold used during FY 2008 and prior years was set too high, resulting in a material understatement of capitalized asset balances in prior years, and as of September 30, 2008 (See Comment II-A, *Financial Reporting*).

3. CBP:

- Did not adopt adequate policies and procedures in place to properly account for steel purchases and construction of the U.S. border fence accurately and timely. CPB initially recorded some capital asset purchases, related to the U.S. border fence construction as an expense, and several months later, properly reversed and capitalized the assets. For example, as of the end of August 2008, $224 million of steel was purchased; however, none was recorded as a capital asset until September 2008.
- Does not have adequate accounting processes and controls to ensure that transfers of assets from CIP to completed PP&E are recorded in the general ledger timely. As a result, CBP performed a review of asset additions to quantify the impact of the untimely transfers. As of September 30, 2008, CBP recorded an additional $48 million in accumulated depreciation and depreciation expense to correct for the identified errors.

Cause/Effect: FEMA has not devoted attention to accounting for software development in the past assuming the costs incurred to develop software for internal use were immaterial for DHS consolidated financial reporting purposes. However, in recent years, FEMA has increased its expenditures on internal use software to update its IT systems and improve their capabilities to support its mission. Although FEMA's Office of the Chief Financial Officer (OCFO) attempted to gather certain costs to capitalize in the second half of FY 2008, the data needed to account for the software costs could not be easily obtained from other offices. FEMA and DHS financial statements could be materially misstated without better processes for tracking and accounting for internal use software costs.

TSA management was not fully aware of the accounting requirements of SFFAS No. 6, *Accounting for Property, Plant, and Equipment,* until auditor inquiries led TSA to investigate its accounting policies for equipment, particularly related to internal use software and treatment of other direct costs. This control deficiency is also related to the conditions described in Comment II-A, *Financial Reporting*, and Comment III-G, *Entity Level Controls*. Extensive resources, including contractor assistance, were committed in FY 2008 in an attempt to identify the full extent of the error, and properly account for capital assets; however,

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considering the scale of the project, management was not able to fully complete the work prior to the completion of the DHS 2008 AFR.

As the SBI initiative is not part of CBP's normal course of business, CBP did not timely implement processes to record these transactions properly. Accordingly, for several months throughout the year, CBP's financial statements did not accurately reflect the construction activity.

Criteria: SFFAS No. 10, *Accounting for Internal Use Software,* provides requirements for the capitalization and reporting of internal use software development costs. Per paragraph 16, the capitalizable cost should include "….the full cost (direct and indirect) incurred during the software development stage. Per SFFAS No. 10, paragraphs 18-20, "For COTS [Commercial off-the-shelf] software, capitalized cost should include the amount paid to the vendor for the software. For contractor-developed software, capitalized cost should include the amount paid to a contractor to design, program, install, and implement the software. Material internal cost incurred by the federal entity to implement the COTS or contractor-developed software and otherwise make it ready for use should be capitalized…Costs incurred after final acceptance testing has been successfully completed should be expensed."

Per the USSGL TFM S2 08-03, Part I Fiscal Year 2008 Reporting, Accounts and Definitions, account 1832, Internal Use Software in Development, "includes the full cost, as defined in FASAB SFFAS No. 10, *Accounting for Internal Use Software,* incurred during the software development stage of (1) contractor-developed software, and (2) internally developed software. Upon completion, these costs will be transferred to USSGL account 1830, Internal Use Software."

SFFAS No. 6, paragraph 38, states that general PP&E along with associated accumulated depreciation/amortization should be removed from the asset accounts in the period of disposal, retirement, or removal from service. Any difference between the book value of the PP&E and amounts realized should be recognized as a gain or loss in that period. SFFAS No. 6 requires all costs incurred to place an asset in service, including transportation, storage, and installation costs, to be capitalized and depreciated over the asset's useful life. Also, SFFAS No. 6 requires that upon completion of a construction project, costs should be capitalized into fixed assets.

GAO *Standards for Internal Control in the Federal Government (Standards)* require that internal control and all transactions and other significant events be clearly documented and readily available for examination. The Joint Financial Management Improvement Program (JFMIP), *Property Management Systems Requirements,* state that the agency's property management system must create a skeletal property record or have another mechanism for capturing information on property in transit from the providing entity (e.g., vendor, donator, lender, grantor, etc.).

Recommendations: We recommend that:

1. FEMA:
    a) Perform a review of all internal use software implemented and currently in development, to include the following:
        i) Compile the supporting documentation for all significant software projects less than three years old, including NextGen, PRISM, NDgrants, EMMIE, TAV, and Sunflower software, and account for the costs in accordance with SFFAS No.10;
        ii) Develop and implement a formal tracking system for the costs related to the development and implementation of internal use software, and use the information from the tracking system to either record actual costs of internal use software in the general ledger or validate estimated costs on a periodic basis (at least annually);
        iii) Ensure that costs of software in development are recorded in USSGL account 1832, and the full cost of the software is transferred to USSGL account 1830 after final acceptance testing is completed; and
        iv) Reclassify costs of software in development that are currently recorded in USSGL account 1830 to USSGL account 1832, and reverse the amortization expense recorded to date for the costs of software in development.

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2. TSA:

   a) Complete the review currently in process over idle assets, other direct costs, and internal use software, and record the proper correcting adjustments in the general ledger;

   b) Develop and implement policies and procedures, including appropriate supervision and management oversight, to include accountability, to account for idle assets, other direct costs, and internal use software in accordance with SFFAS No. 6 and SFFAS No. 10 on an on-going basis; and

   c) Examine asset purchases and establish an appropriate dollar threshold for capitalization of purchases to ensure that asset purchases are presented as capital assets, and depreciated in compliance with GAAP (See Comment II-A, *Financial Reporting*).

3. CBP:

   a) Establish policies and procedures to capitalize costs of construction-in-progress accurately and timely; and

   b) Improve its policies and procedures to ensure that assets are transferred from CIP to in-use property timely, when the assets are placed in service.

II-E Actuarial and Other Liabilities (FEMA, FLETC, ICE, and S&T)

Background: In FY 2007, Grants and Training (G&T) operations were transferred to FEMA as a result of the *Post-Katrina Emergency Management Reform Act of 2006*. FEMA is now responsible for accounting and financial reporting for all legacy G&T grants, including the grant accrual methodology. FEMA manages the NFIP and relies on insurance underwriters to provide an estimate for NFIP loss reserves for financial statement purposes.

	2008	2007	2006
FEMA	SD	MW	MW
G&T*		MW	MW
FLETC	SD		
ICE	SD		
S&T	SD		
TSA	C	SD	SD

* G&T merged with FEMA in 2007

The Federal Law Enforcement Training Center (FLETC) maintains a number of firing ranges in at least four locations. FLETC also maintains facilities that contain lead-based paint and asbestos, where environmental liabilities may exist. The Immigration and Customs Enforcement (ICE) and Science and Technology (S&T) own land, buildings, and other structures and facilities, including firing ranges, that may be contaminated, or have underground storage tanks. S&T also owns the Plum Island Animal Disease Center and Orient Point, and has leased laboratory space in Manhattan.

In FY 2008, TSA corrected its material weakness in the unfunded employee leave process.

Conditions: We noted the following internal control weaknesses related to other liabilities at FEMA, FLETC, ICE, and S&T:

1. FEMA:

   - Had not fully implemented planned internal controls over its grant accrual as FEMA management made revisions to the accrual methodology through September 2008;

   - Did not work with its contractor actuary before the late October 2008 issuance of the final actuarial report for the flood insurance liability to ensure that the materiality standard used in the report was acceptable to management for financial statement reporting purposes;

   - Did not timely communicate to its auditors the details of significant changes to the methodology used in development of the flood insurance liability, particularly for hurricanes that occurred in August and September; and

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- Does not have sufficient policies and procedures in place to fully comply with the *Single Audit Act Amendments of 1996* and related OMB Circular No. A-133, *Audits of States, Local Governments, and Nonprofit Organizations* (see Exhibit IV-L, *Single Audit Act Amendments of 1996*).

2. FLETC, ICE, and S&T:

- Have not fully implemented policies and standard operating procedures that will allow management to fully assert that environmental liabilities have been recorded, and disclosed in the financial statements, in accordance with applicable accounting standards. We noted that:
  - FLETC does not have a process in place whereby the Environmental and Safety Division identifies the existence of all environmental liabilities, and periodically reports an estimated clean up cost to the Finance Division. A detailed review and report was provided to the Finance Division in response to an auditor inquiry. In addition, FLETC did not consider all potential liabilities in its estimate, e.g., those that may relate to a time period before FLETC took possession of the Glynco facility from the Department of Defense;
  - ICE has not fully implemented a process and internal controls to identify, estimate, and report the potential environmental and disposal liability, and management stated that it had not performed or updated its assessment during FY 2008; and
  - Some of the remediation projects at S&T do not meet the criteria of an environmental liability while others do not include all costs to remediate the liability. We also noted that S&T has not performed a comprehensive survey to ensure the completeness of their environmental liability estimate.
- Each of the components do not have sufficient policies, procedures, and processes in place to fully comply with FASAB Technical Release No. 2, *Determining Probable and Reasonably Estimable for Environmental Liabilities in the Federal Government,* which requires the exercise of due care during the environmental liability estimation process. This can include examining facilities transferred to DHS for possible environmental issues.

Cause/Effect: FEMA accounting staff developed a new grant accrual methodology during FY 2008; however, they continued to make revisions throughout the year. FEMA does not have adequate procedures in place to monitor the decisions of its contractor actuary in the development of the flood insurance liability. As a result, the materiality standard used in the insurance loss reserve may be too high for management to accept for financial statement reporting purposes.

FLETC, ICE, and S&T have historically not considered environmental liabilities to be a matter that could have a material effect on the financial statements, and exercising due care involves either the use of an outside specialist or in-house engineering capabilities. Coordination with persons outside of the accounting departments has hampered the process. In cases where the appropriate expertise has been identified, the nature and extent of instructions provided by the accounting division has not been adequate to clearly describe the purpose and outcome of the inquiry.

Criteria: GAO *Standards* hold that transactions should be properly authorized, documented, and recorded accurately and timely. In addition, the *Standards* state that "Internal control should generally be designed to assure that ongoing monitoring occurs in the course of normal operations. It is performed continually and is ingrained in the agency's operations. It includes regular management and supervisory activities, comparisons, reconciliations, and other actions people take in performing their duties."

OMB Circular No. A-133, Subpart D, provides for the responsibilities of federal agencies and pass-through entities for audits of states, local governments, and non-profit organizations.

SFFAS No. 6, paragraph 85, defines environmental cleanup costs as those costs for removing, containing, and/or disposing of (1) hazardous waste from property, or (2) material and/or property that consists of hazardous waste at permanent or temporary closure or shutdown of associated PP&E. Paragraph 88 states that these cleanup costs meet the definition of liability provided in SFFAS No. 5. In addition, SFFAS No. 6, paragraph 96, states that cleanup cost estimates shall be revised periodically to account for material changes due to inflation or deflation and changes in regulations, plans and/or technology. New remediation

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cost estimates should be provided if there is evidence that material changes have occurred; otherwise estimates may be revised through indexing.

FASAB Technical Release No. 2 states that an agency is required to recognize a liability for environmental cleanup costs as a result of past transactions or events when a future outflow or other sacrifice of resources is probable and reasonably estimable. The Agency must exercise "due care" in developing its estimated environmental liability. Examples of due care are provided in FASAB Technical Release No. 2.

Recommendations: We recommend that:

1. FEMA:
   a) Fully implement the designed internal controls over the quarterly grant accrual;
   b) Develop and implement policies and procedures for the Mitigation Division and the OCFO to consult with the actuary developing the flood insurance liability before year-end to review and agree with the materiality standard for insurance loss reserves to be used in the final year-end report. This agreement and related rationale should be documented;
   c) Develop and implement policies and procedures for the Mitigation Division to consult with the actuary developing the flood insurance liability before year-end to determine if any significant methodology changes will be made in the final year-end report. The details of any changes should be communicated timely to the auditor; and
   d) Implement policies and procedures to ensure full compliance with OMB Circular No. A-133.
2. FLETC, ICE, and S&T:
   a) Finalize and implement standard operating procedures requiring an annual review / update of environmental liabilities recorded in the general ledger, in accordance with applicable accounting standards, including procedures for:
      i) Identification and reporting of all material environmental liability estimates;
      ii) Communication, including written instructions, to serve as a memorandum of understanding between the financial / accounting offices and engineers or specialists who have expertise to identify possible pollutants and estimate the clean-up costs; and
      iii) Observance of due care in the process of maintaining the environmental liability estimate for financial statement purposes;
   b) Design and implement sufficient management level controls to ensure the completeness, accuracy, and proper disclosure of environmental liabilities; and
   c) Ensure that all estimates of environmental liabilities are supported by adequate documentation and reviewed by financial management for reasonableness. The supporting documentation should include assumptions made, the elements of the estimate calculation, and support for each element (e.g. specific type of contamination, square footage of the contaminated area or other applicable unit of measurement), the rate or cost per unit to remediate the specific type of contamination, and support for the determination of the rate or cost per unit for remediation.

II-F Budgetary Accounting (FEMA and CBP)

	2008	2007	2006
CBP	SD		
FEMA	MW	MW	MW
TSA	C	MW	MW

Background: Budgetary accounts are a category of general ledger accounts where transactions related to the receipt, obligation, and disbursement of appropriations and other authorities to obligate and spend agency resources are recorded. Combined, DHS has over 350 separate Treasury account fund symbols (TAFS), each with separate budgetary accounts that must be maintained in accordance with OMB and Treasury guidance. The TAFS cover a broad spectrum of budget authority, including annual, multi-year, and no-year appropriations; and

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several revolving, special, and trust funds. Accounting for budgetary transactions in a timely and accurate manner is essential to manage the funds of the Department and prevent overspending of allotted budgets.

In FY 2008, FEMA implemented a mission action plan (MAP) to perform an extensive review of its open obligations related to mission assignments with other Federal agencies. As a result, FEMA was able to deobligate over $1 billion in funds prior to year-end, and make those funds available for disaster relief. FEMA improved its processes and internal controls over the mission assignment obligation and monitoring process in FY 2008; however, some control deficiencies remain.

In FY 2008, TSA corrected the material weakness in its process of accounting for undelivered orders.

Conditions: We noted the following internal control weaknesses related to budgetary accounting at FEMA and CBP:

1. FEMA:

   - Did not consistently and adequately monitor the status of its obligations as part of its normal operations and ensure the timely deobligation of mission assignments. We noted the following:

     - Although a review over UDOs was performed and documented by FEMA during the third and fourth quarters of FY 2008, appropriate follow-up action was either not performed or not documented for 3 of 57 applicable cases following the third quarter review, and for 6 of 54 cases following the fourth quarter review; and

     - In samples of 85 and 151 mission assignment obligations tested as of June 30 and September 30, 2008, respectively, approximately 27 percent and 5 percent, respectively, were past their projected end dates by more than 90 days and were considered testwork exceptions.

   - Could not provide all supporting documentation for our sample of UDOs other than mission assignments and grant UDOs. We noted that responsible parties could not be readily identified, and the files were not accessible, or maintained in a form that clearly supported the balances reported in the financial statements.

2. CBP is not enforcing its policies and procedures (Directive 1220-011B) to monitor and deobligate or close-out its obligations in a timely manner. We noted that CBP did not properly deobligate inactive undelivered orders for approximately 58% of a sample as of March 31, 2008. In response to an audit inquiry, CBP initiated a review of open obligations and subsequently deobligated approximately $84 million in open obligations in FY 2008.

Cause/Effect: Other Federal Agencies (OFAs) did not always provide FEMA with timely progress reports that included sufficient cost and billing data, or with a timely response to validation requests of open mission assignments. Sufficient documentary evidence was not obtained and/or documented timely for Mission Assignment Manager follow-up procedures with the OFAs. The errors in each sample resulted in known overstatements, and most likely overstatements in undelivered orders.

CBP did not properly monitor all open obligations, and consequently government funds may be committed and not made available for CBP, or other Federal expenditures, for longer periods of time than necessary.

Criteria: FEMA's SOP for *Processing Mission Assignment and Interagency Payments for Fund Code 06*, updated April 2007, establishes the process for mission assignment closeouts. If no activity has been recorded within the last 90 days, the Disaster Finance Branch initiates the closeout process with the region or headquarters.

The FEMA Form 90-129, *Mission Assignment Agreement,* states that the OFA is responsible for submitting a Mission Assignment Monthly Progress Report to FEMA to include cost data when mission assignments take more than 60 days to complete, including billing.

According to GAO *Standards,* "transactions should be promptly recorded to maintain their relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event from the initiation and authorization through its final classification in

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summary records." Further, "control activities help to ensure that all transactions are completely and accurately recorded."

CBP Directive 1220-011B states that financial plan holders will review Systems, Applications, and Products (SAP) reports each quarter to reconcile their obligations to supporting records.

Recommendations: We recommend that:

1. FEMA:

   a) Consistently monitor the status of its obligations as part of the normal business process. Ensure that all mission assignments are reviewed and deobligated timely. In addition:

      i) Finalize the development and implementation of updated mission assignment policies and procedures;

      ii) Enforce the requirement that all OFAs submit not only a progress report when the mission assignment takes more than 60 days to complete, but a progress report every additional 30 days that the project remains either programmatically or financially incomplete; and

      iii) Ensure that appropriate personnel consistently perform and follow-up on the results of the quarterly obligation reviews to determine whether the remaining balance on a UDO is valid or should be deobligated.

   b) Update and improve procedures for documentation of supporting UDO information, including points of contact for information, so that supporting information is readily available for management review and audit purposes.

2. CBP:

   a) Continue to enforce CBP Directive 1220-011B to ensure that obligations are reviewed and deobligated timely.

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III-G Entity Level Controls (USCG, FEMA, and TSA)

Background: In FY 2003 – FY 2007, we reported conditions that led to a Departmental level material weakness in entity level controls. The Department has undertaken and completed several steps designed to strengthen its entity and process level internal controls, and thereby improve the reliability of financial reporting. These steps are documented in the *Internal Control over Financial Reporting Playbook* released in March 2008, and in component level Mission Action Plans (MAPs) finalized early in FY 2008. The Department continued its OMB Circular No. A-123 program with the help of an external contractor.

Although weaknesses in entity level controls remain at FEMA and USCG and new entity level findings are reported at TSA, we now believe that steps taken by the Department and the Office of the Chief Financial Officer in FY 2007 and 2008 have strengthened the internal control framework and substantially mitigated component weaknesses, supporting a downgrade of our entity level control findings to a significant deficiency. The comments below should be read in conjunction with Comments I-B and II-B, *Information Technology General and Application Controls*, which describe entity level control weaknesses in Department and Component IT systems.

The Coast Guard updated its MAPs and *Financial Strategy for Transformation and Audit Remediation* (FSTAR) in FY 2008. The FSTAR is a comprehensive plan to identify and correct the root causes of control deficiencies. However, most of the actions outlined in FSTAR are scheduled for after FY 2008, and consequently, we repeat most of our entity level control findings identified at Coast Guard in previous years.

FEMA committed to, and substantially achieved, their MAPs to eliminate account balance qualifications identified in the Independent Auditors' Report (IAR) in FY 2007. FEMA also made modest progress toward correction of its entity level control deficiencies in FY 2008. While progress has been made, some entity level control deficiencies identified at FEMA in previous years continued during FY 2008, and are repeated below.

In FY 2008, TSA successfully addressed some control deficiencies that contributed to IAR qualifications in previous years. However, during our audit, we noted new deficiencies that are indicative of continued and more significant weaknesses in entity level controls at TSA.

Conditions: We noted the following internal control weaknesses related to entity level controls at USCG, FEMA and TSA:

1. USCG:

   - Has not fully implemented a financial management structure where:
     - GAAP is applied and financial statement balances are appropriately supported, interfering with the Coast Guard's ability to assert to the completeness, existence (validity), accuracy, valuation, or presentation of their financial data, with the exception of investments and legal liabilities;
     - Financial management oversight functions complete with an organizational chart, job descriptions, roles and responsibilities, and skill sets required, are well defined. Appropriate and clear internal reporting relationships have been established resulting in effective financial guidance and oversight over internal and external distribution of financial information, particularly related to the *Federal Managers' Financial Integrity Act of 1982* (FMFIA); and
     - The financial management infrastructure is appropriately staffed with experienced financial managers and staff to expeditiously identify and address control weaknesses, develop and implement effective policies, procedures, and internal controls to ensure that data supporting financial statement assertions are complete and accurate.
   - Has not fully implemented an on-going entity-wide risk assessment.
   - Does not have a process to monitor and control timely completion of the MAP or FSTAR milestones, and update the status of completion of such milestones.

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2. FEMA:

- Has not provided the CFO with clearly defined and complete authority for all financial accounting policy, processes, and control functions throughout the agency.
- Has not effectively communicated the importance of strong financial management and internal controls throughout the agency, resulting in several offices not fully cooperating with the OCFO related to accounting and auditing matters.
- Has not developed sufficiently effective methods of communication to ensure that significant financial-related events outside of the OCFO (e.g., changes in third party financial services providers and development of new software projects) are timely communicated to the OCFO to ensure proper and timely accounting and reporting consideration.
- Has not completed the placement of sufficient financial and accounting resources in its regional offices, which contributes to certain issues in mission assignment accounting. Mission assignment obligations are not closed out timely, and in a sample of 168 mission assignment payments selected for testwork as of March 31, 2008, we noted that approximately 16% of the payments were not properly reviewed and approved in accordance with FEMA policy.
- Has not documented and/or updated formal policies and procedures (including desk manuals) for many of the roles, responsibilities, processes, and functions performed within FEMA. For example, in FY 2008, we noted that improvements are needed in the formal documentation of policies and procedures related to *Anti-deficiency Act* compliance, policies for monitoring and responding to OMB Circular No. A-133 reports, Office of Inspector General (OIG) reports, and GAO report findings and recommendations; and the quarterly process for estimating accruals (including accrual validation).
- Has identified the Internal Controls Branch's sole function as the implementation of policies and procedures to close findings issued as a result of multiple external audits. Its mission does not include internal control monitoring to assess the overall quality and performance of operations on a continual basis.
- Has not committed sufficient resources to ensure that personnel attend required ethics training.

3. TSA:

- Lacks a sufficient number of skilled accounting staff in the proper positions in the Financial Statements and Report Branch to ensure that accounting policies, procedures, and internal controls over financial reporting are appropriate, and continuously effective; and to ensure that accounting principles are correctly applied in a timely manner.
- The organizational structure in finance and accounting, including an understanding and assignment of roles and responsibilities for financial oversight, supervision, and review may not be optimally aligned with its resources.
- Did not provide contractors retained to prepare materials for the financial statement audit with adequate management direction, supervision, and review, resulting in substantial rework, and delays in completion of the audit.
- Has weaknesses in communication, instruction, training, supervision and/or coordination with personnel outside of the office of financial management, that contribute to control weaknesses in processes dependent on operations. For example, idle assets maintained in an off-site warehouse by operational personnel may not be accounted for properly, due to a lack of understanding of, or willingness to follow, financial policies.
- Lacks sufficient oversight of financial reporting functions and consequently errors or misapplication of GAAP may go undetected, in some cases for several years, or until questioned by an auditor.

These conditions lead directly to a number of audit findings in FY 2007 and in FY 2008 that when considered in aggregate, point to weaknesses in entity level controls. FY 2008 new findings reported elsewhere in our report include:

- Two new material weaknesses in internal control, Comment II-A, *Financial Reporting*, and Comment II-D, *Capital Assets and Supplies*;
- Significant restatements to prior year financial statements to correct multiple errors in capital assets balances described in Comment II-D, *Capital Assets and Supplies*, and to correct a misapplication of GAAP, described in Comment II-A, *Financial Reporting*; and
- Inability to complete its investigation of the errors in capital assets, referred to in Comment II-D, *Capital Assets and Supplies*, and record correcting adjustments prior to the completion of the DHS FY 2008 AFR, resulting in a qualification in the Independent Auditors' Report.

Cause/Effect: The Coast Guard's management has acknowledged that longstanding procedural, control personnel, IT, and cultural issues have impeded progress toward installing an effective financial management structure. The conditions described above continue to prevent the Coast Guard and DHS from timely preparation of accurate financial information and reports, and have also contributed to the conditions reported in Exhibit I-A, *Financial Reporting*, as well as other control deficiencies described in Exhibit I.

FEMA devoted substantial resources to correcting financial statement balances that could not be audited in FY 2007. Consequently, FEMA devoted comparatively less attention to improving the underlying accounting processes and correcting control deficiencies in FY 2008.

TSA, similar to FEMA, devoted resources to correcting financial statement balances that could not be audited in FY 2007. Management attempted to supplement its staff with contractors; however, the nature and extent of issues in capital asset balances, including the need to restate prior year reported balances, overwhelmed TSA's capacity to properly staff and supervise the project, and to fully correct control deficiencies in FY 2008. Also, TSA has not updated its entity level control self assessment (necessary for OMB Circular No. A-123 purposes) since 2006, which may have identified some or all of these conditions before our audit.

In their FY 2008 representations made to the Secretary pursuant to the *DHS Financial Accountability Act*, USCG and FEMA, each stated that they had not yet completed enough testing to provide reasonable assurance that internal controls were achieving their intended objectives.

Criteria: OMB Circular No. A-123, *Management's Responsibility for Internal Control*, as revised, states that internal controls are the organization, policies, and procedures that agencies use to help program and financial managers achieve results and safeguard the integrity of their programs.

FMFIA requires that agencies establish internal controls according to standards prescribed by the Comptroller General. These standards are established in the GAO *Standards for Internal Control in the Federal Government (Standards).* The GAO defines internal control as an integral component of an organization's management that provides reasonable assurance that the following objectives are achieved: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations.

The GAO *Standards* identify the control environment as one of the five key elements of control, which emphasizes the importance of conscientiousness in management's operating philosophy and commitment to internal control. These standards cover controls such as human capital practices, supervisory reviews, policies, procedures, monitoring, and segregation of duties.

Recommendations: We recommend that:

1. USCG:
   a) Review and enhance the entity level controls MAP to include steps to fully assess entity level controls, develop effective corrective actions, and implement improved financial processes and systems;

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b) Evaluate how recommendations from recent internal organizational and process assessments impact the conditions cited above, as well as the other conditions identified in Exhibit I-A, *Financial Reporting,* such as the number and type of personnel and resources needed, along with the requisite skills and abilities necessary, to provide effective guidance and oversight to program offices that are significant to financial management and reporting, and make the recommendations to senior management, as appropriate; and

c) Ensure that its FSTAR/MAP actions as designed and performed are:

i) Effective in addressing all of the material weaknesses described in Exhibit I; and

ii) Coordinated and prioritized with input from the Department's CFO to address matters that are preventing the Department from preparing reliable financial statements, and executing its fiscal management responsibilities.

2. FEMA:

a) Provide the CFO with clear authority to develop and implement accounting and financial reporting policies, procedures, and internal controls throughout the Agency. Program offices should be required to adhere to policies;

b) Consistently emphasize the importance of strong financial management and internal controls throughout the agency;

c) Develop communication protocols agency-wide to ensure that significant financial-related events outside of the OCFO are timely communicated to the OCFO for proper and timely accounting and reporting consideration;

d) Fully implement plans to place comptrollers in each regional office, to address weaknesses related to mission assignment accounting and implementation of financial directives described above;

e) Ensure that formal policies and procedures (including desk manuals) are documented and current for all significant roles, responsibilities, processes, and functions performed within FEMA;

f) Expand the mission and staffing of the Internal Controls Branch to perform internal control monitoring to assess the overall quality and performance of operations on a continual basis; and

g) Develop procedures and dedicate resources to provide, track compliance with, and monitor the annual and new hire ethics training requirements.

3. TSA:

a) Update the OMB Circular A-123 review of entity level controls and complete the GAO self assessment tool for entity level controls. Evaluate the deficiencies identified by the process and take appropriate corrective actions, including the development of a MAP for OCFO approval in FY 2009;

b) Conduct a human resource needs assessment and financial organizational assessment to identify gaps in skill-sets, hire or re-align personnel to fill the gaps, and assign personnel with responsibilities that best match their expertise;

c) Consider updating the financial organizational structure based on the human resources needs assessment;

d) Strengthen the monitoring and supervision process over financial reporting, and use of contractors;

e) Consistently emphasize the importance of strong financial management and internal controls throughout the agency;

f) Improve communications, training, instruction and oversight of non-accounting personnel that are essential to the accounting process, and fair and timely presentation of financial statement balances; and

g) Consider additional training to ensure that all general ledger and financial management personnel are kept current of GAAP requirements.

III-H Custodial Revenue and Drawback

Background: CBP collects approximately $31.4 billion in annual import duties, taxes, and fees on merchandise arriving in the United States from foreign countries (identified below as the Entry Process). Receipts of import duties and related refunds are presented in the statement of custodial activity in the DHS financial statements.

Drawback is a remittance, in whole or in part, of duties, taxes, or fees previously paid by an importer. Drawback typically occurs when the imported goods on which duties, taxes, or fees have been previously paid, are subsequently exported from the United States or destroyed prior to entering the commerce of the United States.

Our findings on the Entry Process include In-bond, Bonded Warehouse, Foreign Trade Zones, and the Compliance Measurement Program (CM). In-bond entries occur when merchandise is transported through one port; however, the merchandise does not officially enter U.S. commerce until it reaches the intended port of destination. Bonded Warehouses (BWH) are facilities, under the joint supervision of CBP and the Bonded Warehouse Proprietor, used to store merchandise that has not made entry into the United States commerce. Foreign Trade Zones (FTZ) are secured areas under CBP supervision that are used to manufacture goods that are considered outside of the United States commerce for duty collection.

CM is the primary method by which CBP measures risk in the areas of cargo security, trade compliance, and revenue collection. CBP utilizes the CM program to measure the effectiveness of its control mechanisms deployed, and its execution in collecting revenues rightfully due to the U.S. Department of the Treasury.

Conditions: We noted the following internal control weaknesses related to custodial activities at CBP:

Related to drawback:

- The Automated Commercial System (ACS) lacks automated controls to detect and prevent excessive drawback claims and overpayments, necessitating inefficient manual processes that do not effectively compensate for these automated controls.
- ACS lacks controls to prevent the overpayment of drawback claims at the summary line level.
- Drawback review policies do not require drawback specialists to review all, or a statistically valid sample, of prior drawback claims against the underlying consumption entries (UCE) to determine whether, in the aggregate, an excessive amount was claimed.
- Drawback review policy and procedures allow drawback specialists, with supervisory approval, to judgmentally decrease the number of ACS selected UCEs randomly selected for review, thus decreasing the review's effectiveness. Further, CBP implemented a new sampling methodology for selecting UCEs; however, this methodology is not considered to be statistically valid.
- The period for document retention related to a drawback claim is only three years from the date of payment. However, there are several situations that could extend the life of the drawback claim well beyond three years.

Related to the Entry Process:

- CBP is unable to determine the status of the in-bond shipments and lacks policies and procedures that require monitoring the results of in-bond audits and require the review of overdue immediate transportation in-bonds or air in-bonds.
- CBP does not perform an analysis to determine the potential loss of revenue through the in-bond process as a result of goods entering the commerce of the U.S. without formal entry.

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- CM oversight guidelines do not provide complete coverage over the CM program. The ports are not following a consistent set of procedures when performing CM reviews, and there are weaknesses in the oversight and monitoring of the CM program.
- Current BWH and FTZ Compliance Review Manuals lack specific guidance for ports to determine the appropriate risk assessment of a BWH or FTZ. In addition, HQ review of the BWHs and FTZs assessment results can take up to six months to compile and analyze. Furthermore, CBP does not maintain a centrally managed list of all BWHs and FTZs.

Cause/Effect: IT system functionality and outdated IT systems contribute to the weaknesses identified above. For example, CBP is unable to determine the status of the in-bond shipments with the information available within ACS, and CBP does not have the ability to run an oversight report to determine if ports have completed all required audits. For drawback, much of the process is manual until planned IT system functionality improvements are made, placing an added burden on limited resources. CBP's IT systems do not maintain one centrally managed list of all BWHs and FTZs.

The inability to effectively monitor the in-bond process and verify the arrival of in-bond merchandise at the port level can lead to a potential loss in revenue. This potential loss in revenue is due to uncollected duties and fees on in-bond merchandise that has physically entered U.S. commerce without formal entry.

The weaknesses in the CM program could result in CBP incorrectly evaluating the effectiveness of its control environment over the collections of duties, taxes, and fees.

It is possible that BWH/FTZ operators and users may be able to operate BWHs and FTZs that contain merchandise that CBP has no or limited knowledge about.

Criteria: Under FMFIA, management must implement cost-effective controls to safeguard assets and ensure reliable financial reporting. OMB's *Revised Implementation Guidance for FFMIA,* states that financial systems should "routinely provide reliable financial information consistently, accurately, and reported uniformly" to support management of current operations.

The Financial Systems Integration Office (FSIO) publications and OMB Circular No. A-127 outline the requirements for Federal financial systems. The Office of Federal Financial Management's *Core Financial System Requirements,* dated January 2006, states that the core financial system must maintain detailed information sufficient to provide audit trails and to support reconciliation and research activities. OMB Circular No. A-127, *Financial Management Systems,* requires that the design of financial systems should eliminate unnecessary duplication of a transaction entry. Wherever appropriate, data needed by the systems to support financial functions should be entered only once, and other parts of the system should be updated through electronic means consistent with the timing requirements of normal business/transaction cycles.

The *Improper Payments Information Act of 2002* requires agencies to annually review programs and activities and identify any that may be susceptible to significant improper payment. Whenever an agency estimates that improper payments may exceed $10 million, it must also provide a report on what actions are being taken to reduce such payments. In addition to the regulatory requirements stated above, CBP's *Drawback Handbook*, dated July 2004, states that management reviews are necessary to maintain a uniform national policy of supervisory review.

Recommendations: We recommend that CBP:

1. *Related to drawback*:
   a) Implement effective internal controls over drawback claims as part of any new system initiatives, including the ability to compare, verify, and track essential information on drawback claims to the related underlying consumption entries and export documentation for which the drawback claim is based, and identify duplicate or excessive drawback claims;
   b) Implement automated controls within ACS and the Automated Commercial Environment (ACE) to prevent overpayment of a drawback claim;
   c) While ACE is in development, collaborate with ACE developers/engineers to ensure that the new system eliminates the need for statistical sampling of UCE and prior related drawback claims as

drawback claims. In addition, until ACE is implemented, we recommend that CBP explore other statistical approaches for selecting UCEs and prior related drawback claims under the current ACS environment; and

d) Continue to work with the U.S. Congress to lengthen the required document retention period for all supporting documentation so that it corresponds with the drawback claim life cycle.

2. *Related to the Entry Process:*

a) Implement a standard procedure to periodically compile the results of all in-bond audits during the year and develop an analysis function in order to evaluate the importers' compliance with regulations;

b) Develop policies and procedures to monitor the results of in-bond audits at the port level and to require reviews of overdue immediate transportation in-bonds and air in-bonds;

c) Analyze the in-bond program annually to determine the potential loss of revenue relating to in-bonds;

d) Provide additional detail in the CM guidelines, specifying the use of the monitoring report, data queries, and any other tools to provide complete coverage over the CM program. The guidance should also readdress the timing requirements for the monitoring reports or data queries and documentation retention;

e) Conduct periodic training to ensure that all port personnel have comprehensive knowledge of the CM program requirements; and

f) Develop standard operating procedures for conducting risk assessments for all BWHs and FTZs. In addition, develop standardized procedures for HQ or field office oversight to ensure compliance review schedules are being reviewed timely and provide effective training to ensure that all ports are aware of updates and changes to the program and can consistently execute all requirements presented in the compliance review manuals and handbooks.

III-I Deferred Revenue (USCIS)

Background: Throughout the year, the United States Citizenship and Immigration Service (USCIS) receives millions of applications and petitions for various immigration and naturalization benefits. Applications are received and processed at four service centers, the National Benefits Center (NBC), over 30 district offices, and numerous satellite offices. An application fee is associated with most applications received. USCIS recognizes these fees as revenue upon adjudication of the application. The fees associated with applications received but still pending adjudication at the end of a period are considered deferred revenue.

Conditions: We noted the following internal control weaknesses related to deferred revenue at USCIS:

- Deficiencies in policies and procedures over its deferred revenue quality assurance (QA) process. We noted that USCIS:
  - Did not initially use a statistician with experience in developing the type of methodology needed by USCIS for the selection of QA samples;
  - Does not perform deferred revenue 'floor-to-list' QA procedures over CLAIMS 4 naturalization applications located at Service Centers;
  - Does not have detailed QA instructions that ensure consistent practices (non-statistical selection, random selection, etc.) for selecting QA samples in the Service Centers and District Offices;
  - Does not have policies describing and requiring follow-up actions to be carried out when results of the QA fall outside the acceptable range specified in the USCIS sampling methodology; and

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- Personnel performing the deferred revenue QA procedures have a general lack of understanding and/or have differing perceptions as to what constitutes a 'pending' case, and what the QA procedures are meant to validate for financial reporting purposes.

- Does not have policies and procedures that require correction of the errors once discovered. Further, once the errors are identified, there is little formal follow-up to determine the root cause of the error.

Cause/Effect: The deferred revenue QA process and development of management's estimate of deferred revenue is a time consuming process and requires a large use of resources both at the field sites and at USCIS headquarters. Further, enhancements to the manual controls over the application processing process will generally not be made until new application tracking computer systems are implemented. However, error rates indicative of a control deficiency have been identified through the USCIS QA process and exist on USCIS' three largest application tracking systems: CLAIMS 3, CLAIMS 4, and RNACS. These weaknesses may result in a misstatement of deferred revenue, and systemic problems may not be identified and resolved. In addition, USCIS uses multiple, non-integrated systems for processing immigration and naturalization applications.

Criteria: OMB Circular No. A-123 states that internal controls are the organization, policies, and procedures that agencies use to help program and financial managers achieve results and safeguard the integrity of their programs.

According to the USCIS Quality Management Branch (QMB)'s Quality Assurance procedures guidance and client discussion, an analysis is required to be performed on all results that Headquarters receives from the District Offices and Service Centers. The analysis further verifies that the information that is being reported is complete and accurate. If any discrepancies are noted, Headquarters is to follow up with the issue and make sure the issue has been resolved.

Recommendations: We recommend that:

1. USCIS:

   a) Revise the design of the deferred revenue QA process so that Service Centers perform 'Floor-to-List' testing of CLAIMS 4 naturalization applications in addition to CLAIMS 3 immigration applications, to ensure the completeness of deferred revenue;

   b) Institute specific, detailed sampling instructions and QA training to ensure uniformity in the manner in which 'Floor-to-List' applications are selected and the validity of results are analyzed;

   c) Revise the design of the deferred revenue QA process at QMB so that a prescribed set of steps are carried out whenever quarterly QA results are outside the acceptable deviation rate;

   d) Enhance the design of the deferred revenue QA process to include a risk-based over-sampling of previous quarters' results, either by location or application type, to help identify and resolve the root cause of the errors;

   e) Train the individuals performing the various aspects of the deferred revenue QA process on the objectives of the QA as well as definitions of 'pending' applications for deferred revenue purposes;

   f) Correct the errors in application status when identified through the deferred revenue QA process to improve the integrity of system data relied on for financial reporting purposes, and analyze each error identified to determine whether there are any common causes of the errors that occur;

   g) Track all pending applications within one system or in a series of systems that are integrated; and

   h) Evaluate the overall data quality within the various systems to plan for pre-conversion validation of data.

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(Exhibits I and II include Comments A – F, and Exhibit III presents Comments G – I)

All of the compliance and other matters described below are repeat conditions from FY 2007.

IV-J *Federal Managers' Financial Integrity Act of 1982* (FMFIA)

Office of Management and Budget (OMB) Circular No. A-123, *Management's Responsibility for Internal Control*, requires agencies and Federal managers to: (1) develop and implement internal controls; (2) assess the adequacy of internal controls; (3) separately assess and document internal control over financial reporting; (4) identify needed improvements; (5) take corresponding corrective action; and (6) report annually on internal controls. During FY 2008 and 2007, the Department of Homeland Security (DHS or the Department) developed an annual *Internal Controls over Financial Reporting Playbook* to implement corrective actions and support management assurances by performing tests of design and operating effectiveness on entity level controls and other financial accounting and reporting processes. DHS' implementation of OMB Circular No. A-123 facilitates compliance with FMFIA. The *DHS Financial Accountability Act of 2004* requires DHS to submit an annual audit opinion of internal control over financial reporting.

While we noted the Department overall has taken positive steps toward full compliance with FMFIA, OMB Circular No. A-123, and the *DHS Financial Accountability Act*, the Coast Guard has not fully established effective systems, processes, policies, and procedures to develop and implement internal accounting and administrative controls, and conformance of accounting systems. In addition, the Transportation Security Administration (TSA), National Preparedness Directorate (NPPD), and the Federal Emergency Management Agency (FEMA)'s control assessment processes require improvement to ensure full compliance with FMFIA.

Recommendation: We recommend that the Coast Guard, TSA, NPPD, and FEMA fully implement the FMFIA process, as prescribed by the OCFO, to ensure full compliance with FMFIA and its OMB-approved plan for Circular No. A-123 implementation in FY 2009.

IV-K *Federal Financial Management Improvement Act of 1996* (FFMIA)

FFMIA Section 803(a) requires that agency Federal financial management systems comply with (1) applicable Federal accounting standards; (2) Federal financial management system requirements; and (3) the United States Government Standard General Ledger (USSGL) at the transaction level. FFMIA emphasizes the need for agencies to have systems that can generate timely, reliable, and useful information with which to make informed decisions to ensure ongoing accountability. OMB Circular No. A-123 requires agencies and Federal managers to: (1) develop and implement internal controls; (2) assess the adequacy of internal controls; (3) separately assess and document internal control over financial reporting; (4) identify needed improvements; (5) take corresponding corrective action; and (6) report annually on internal controls. During FY 2008, DHS OCFO continued with its implementation of OMB Circular No. A-123 by performing tests of design and operating effectiveness on entity level controls and other financial accounting and reporting processes as planned. The *DHS Financial Accountability Act of 2004* requires DHS to submit an annual audit opinion of internal control over financial reporting.

While we noted the Department overall has taken positive steps toward full compliance with FFMIA, the Coast Guard, CBP, FEMA, FLETC, and TSA did not fully comply with at least one of the requirements of FFMIA. The reasons for noncompliance are reported in Exhibits I, II, and III. The Secretary of DHS also has stated in the Secretary's Assurance Statements dated November 13, 2008, as listed in Management's Discussion and Analysis (MD&A) of the Department's 2008 *Annual Financial Report* (AFR), that the Department cannot provide assurance that its financial management systems are in substantial compliance with the requirements of FFMIA. The Department's remedial actions and related timeframes are also presented in that section of the AFR.

An element within FFMIA Federal system requirements is ensuring security over financial management information. This element is addressed further in the *Federal Information Security Management Act of 2002* (FISMA), which was enacted as part of the *E-Government Act of 2002*. FISMA requires the head of each agency to be responsible for (1) providing information security protections commensurate with the risk and magnitude of the harm resulting from unauthorized access, use, disclosure, disruption, modification, or destruction of (i) information collected or maintained and (ii) information systems used or

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operated; (2) complying with the requirements of the Act and related policies, procedures, standards, and guidelines, including (i) information security standards under the United States Code, Title 40, Section 11331 and (ii) information security standards and guidelines for national security systems; and (3) ensuring that information security management processes are integrated with agency strategic and operational planning processes.

We noted weaknesses in financial systems security, reported by us in Exhibits I-B and II-B, *Information Technology General and Application Controls*, which impact the Department's ability to fully comply with FISMA.

Recommendation: We recommend that DHS improve its financial management systems to ensure compliance with the FFMIA, and implement the recommendations provided in Exhibits I, II, and III in FY 2009.

IV-L *Single Audit Act Amendments of 1996,* and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-up,* as revised

During 2007, DHS' Grants and Training (G&T) Directorate merged its grants making function with FEMA. FEMA is now the only DHS component that has a significant grant making operation. OMB Circular No. A-133, *Audits of States, Local Governments, and Non-Profit Organizations,* requires agencies awarding grants to ensure they receive grantee reports timely and to follow-up on Single Audit findings to ensure that grantees take appropriate and timely action. Although FEMA has adopted procedures to monitor grantees and their audit findings, FEMA did not fully comply with provisions in OMB Circular No. A-133 in FY 2008. We noted that FEMA does not always obtain and review grantee Single Audit reports in a timely manner, or follow up on questioned costs and other matters identified in these reports. Because Single Audits typically are performed by other entities outside of DHS, procedures related to these reports are not always entirely within the control of DHS and its components.

OMB Circular No. A-50, as revised, provides guidance for use by executive agencies when considering reports issued by Inspectors General, other executive branch audit organizations, the GAO, and non-Federal auditors, where follow up is necessary. Corrective action taken by management on findings and recommendations is essential to improve the effectiveness and efficiency of government operations, and to support the objectives of sound fiscal management. The DHS OCFO has developed an extensive corrective action plan that requires each component to develop and execute corrective actions to address all material weaknesses in internal controls. This strategy is documented in the DHS *Internal Controls over Financial Reporting* (ICOFR) "Playbook." Progress is monitored by the CFO, and regularly reported to OMB and other outside stakeholders, such as Congressional Committees. We noted that each component has complied with the OCFO directive to develop corrective actions, and they have been reviewed and approved by the CFO. All DHS components have made progress toward remediation of material internal control weaknesses; however, as shown in Exhibits I, II and III, deficiencies identified in prior years have not been fully corrected in FY 2008.

Recommendations: We recommend that:

Regarding Single Audit Act Amendments of 1996:

1. FEMA develop procedures to ensure compliance with its policy to obtain and review grantee Single Audit reports in a timely manner, and follow-up on questioned costs and other matters identified in these reports. We also recommend that FEMA perform the following in FY 2009:
   a) Further develop and implement a tracking system to identify each grantee for which an OMB Circular No. A-133 Single Audit is required, and the date the audit report is due;
   b) Use the tracking system to ensure audit and performance reports are received timely, and follow-up when reports are overdue; and
   c) Perform reviews of grantee audit reports, issue-related management decisions, and ensure that the grantees take appropriate corrective action, on a timely basis.

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Regarding OMB Circular No. A-50, Audit Follow-up, as revised

DHS continue to follow and complete the actions defined in its ICOFR "Playbook," to ensure that audit recommendations are resolved timely and corrective action plans addressing all DHS audit findings are developed and implemented together with appropriate supervisory review in FY 2009.

IV-M *Improper Payments Information Act of 2002*

DHS is required to comply with the *Improper Payments Information Act of 2002* (the Act or IPIA). The Act requires agencies to review all programs and activities they administer annually and identify those that may be susceptible to significant erroneous payments. For all programs and activities where the risk of erroneous payments is significant, agencies must estimate the annual amounts of erroneous payments, and when the estimate exceeds $10 million, report the estimates to the President and Congress with a progress report on actions to reduce them. The agency must report a statistically valid error projection for susceptible programs in its annual Performance and Accountability Report (PAR). To facilitate the implementation of the Act, OMB issued guidance in Memorandum M-03-13, *Implementation Guide for the Improper Payments Information Act of 2002*, and in Appendix C, *Requirements for Effective Measurement and Remediation of Improper Payments*, to OMB Circular No. A-123, which provides a recommended process to meet the disclosure requirements.

In FY 2008, we noted the Department has taken positive steps toward full compliance with IPIA and Appendix C of OMB Circular No. A-123, including strengthening guidance, training, and oversight; identifying programs subject to IPIA; conducting a comprehensive process to assess the risk of programs susceptible to improper payments; and performing sample testing of programs. However, FEMA did not fully comply with the Act in FY 2008. We noted that FEMA:

- Excluded some programs from the scope of the IPIA risk assessment and test work. Specifically, FEMA excluded Mission Assignments and Technology Transfer Program from the scope of the IPIA test work;
- Excluded five programs identified as high risk of significant improper payments during the assessment process from testing; and
- Did not develop Mission Action Plans (MAPs) for five programs identified as "high risk" during the risk assessment process if no statistical sampling was performed to validate those risks during FY2008. FEMA completed a test pilot for these programs.

Recommendation: We recommend that FEMA fully implement the IPIA process, including performing risk assessments for all the programs it administers. We also recommend that FEMA complete its efforts to ensure that all programs identified as susceptible to significant improper payments in its annual risk assessment are subject to sampling, testing and analysis to determine the required statistically valid error rate to be reported in the DHS *Annual Financial Report.*

IV-N *Chief Financial Officers Act of 1990*

The *DHS Financial Accountability Act of 2004* made DHS subject to the *Chief Financial Officers Act of 1990*, as amended, which requires DHS to submit to the Congress and OMB audited financial statements annually. DHS' Office of the Inspector General (OIG) has engaged an independent auditor to audit the September 30, 2008 balance sheet and related statement of custodial activity. Other financial statements, including the statements of net cost, net position, and budgetary resources, are not currently auditable. DHS must be able to represent that its balance sheet is fairly stated, and obtain at least a qualified opinion before it is practical to extend the audit to other financial statements.

Recommendation: We recommend that DHS and its components continue to implement the Mission Action Plans described in DHS' ICOFR "Playbook" (see Comment IV – J, *Federal Managers' Financial Integrity Act of 1982*, above) to remediate the FY 2008 material weaknesses and significant deficiencies, and improve its policies, procedures, and processes, as necessary, to allow management to assert that all financial statements are fairly stated in compliance with accounting principles generally accepted in the United States, and are ready for an independent audit.

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IV-O *Government Performance and Results Act of 1993* (GPRA)

The *Government Performance and Results Act* requires each agency to develop a strategic plan that includes a description of how goals and objectives are to be achieved, including a description of the operational processes, skills and technology, and the human capital and other resources required to meet those goals and objectives. The Department's annual performance plan and performance reports that measure progress toward achieving strategic goals and related performance metrics are also integral to compliance with GPRA. We noted that DHS' Strategic Plan expired on October 1, 2006 and the Department had not provided an updated Strategic Plan prior to September 2008. Consequently, the Department was not in compliance with the requirements of GPRA during FY 2008.

Recommendation: We recommend that DHS ensure full compliance with GPRA by aligning all performance goals to its strategic objectives in the new Strategic Plan in FY 2009.

IV-P *Debt Collection Improvement Act of 1996* (DCIA)

The *DCIA of 1996* (DCIA) is intended to significantly enhance the Federal Government's ability to service and collect debts. Under the DCIA, the Treasury assumes a significant role for improving government-wide receivables management. The DCIA requires Federal agencies to refer eligible delinquent nontax debts over 180 days to U.S. Treasury for the purpose of collection by cross-servicing or the offset program. Our tests of compliance disclosed instances where DHS was not in compliance with certain provisions of the DCIA. Specifically, we noted that due process is not performed in a timely manner to ensure that some eligible debts are forwarded to the Treasury for cross-servicing or the offset program within the timeframes established by DCIA.

Recommendation: We recommend that DHS develop policies and procedures to ensure full compliance with the DCIA in FY 2009.

IV-Q *Anti-Deficiency Act* (ADA)

DHS and Federal Law Enforcement Training Center (FLETC) management notified us of an *Anti-deficiency Act* violation that occurred at FLETC, where a capital lease dating back to FY 2001 was not fully funded. The DHS Secretary has reported the violation to the President of the United States, the President of the Senate, the Speaker of the House of Representatives, and the Comptroller General, as required by 31 U.S.C. Section 1351.

In addition, various other management reviews and OIG investigations are on-going within the Department and its components that may identify ADA violations. The FLETC ADA violation described above relates to one building lease. FLETC has two other similar building leases that have been reviewed by the Department and determined to be operating leases and therefore a violation of ADA has not occurred. The OIG plans to initiate an independent review of the Department's decision to classify the two other FLETC buildings as operating leases. The OIG's review may identify additional ADA violations. The OIG has initiated a review, at FEMA management's request, of certain expenditures occurring in previous years that may have violated the *Anti-deficiency Act.* The Coast Guard management is reviewing a possible ADA violation related to use of funds to purchase assets that may identify a violation of the ADA. NPPD management is continuing their review, initiated in FY 2007, over the classification and use of certain funds that may identify an ADA violation. In addition, NPPD management has initiated a review of certain fees collected for attendance at a DHS-sponsored annual conference that may identify a violation of the *Anti-deficiency Act.*

Recommendations: We recommend that FLETC continue to implement the remedial actions resulting from its internal investigation of this matter. We recommend that the Department, along with the OIG and the other components, complete the internal reviews currently planned or being performed, and properly report the results in compliance with the ADA if necessary.

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Exhibit V – Status of Prior Year Findings

	Summary of Conditions As Reported in 2007 DHS Performance and Accountability Report	Fiscal Year 2008 Status/ Disposition
Material Weaknesses:		
A.	**Financial Management and Oversight**	
A.1	The Coast Guard had not fully implemented a financial management organizational structure that ensures accounting principles are correctly applied and financial statement balances are appropriately supported. The Coast Guard has not established appropriate and clear internal reporting relationships, financial guidance, and oversight over internal and external distribution of financial information. The Coast Guard does not have clear and complete authority and responsibility for all financial accounting policy, processes, and control functions that rests with the CFO, and financial management oversight functions are not clearly defined. The Coast Guard financial management infrastructure is not appropriately staffed with experienced financial managers and staff, and the objectives of sound fiscal management are not embraced by all officers and personnel.	**Partially Repeated** (Exhibit III-G)
A.2	FEMA had not established a financial management organizational structure with clear oversight and supervisory review functions that supports the development and implementation of effective policies, procedures, and internal controls over financial reporting, including a lack of segregation of duties in financial reporting roles and a lack of supervisory review in financial functions. FEMA does not have a sufficient number of experienced financial managers and staff to expeditiously address nonroutine accounting issues. FEMA had not completed and implemented a comprehensive corrective action plan to correct internal control weaknesses as required by OMB Circular A-50, *Audit Follow-up,* as revised. FEMA had not documented and/or updated formal policies and procedures for many of the roles, responsibilities, processes, and functions performed within FEMA. FEMA had not completed the placement of sufficient financial and accounting resources in its regional offices, which contributed to certain issues in Mission Assignment accounting. **(Note: Also includes financial reporting material weaknesses)**	**Partially Repeated** (Exhibits I-A and III-G)
B.	**Financial Reporting**	
B.1	The Coast Guard had not developed and implemented an effective general ledger system. The general ledgers are not compliant with the USSGL. The Coast Guard's financial reporting process was complex and labor-intensive, and required a significant number of "on-top" adjustments. The Coast Guard had deficiencies in its policies, procedures, and controls surrounding its financial reporting process, and did not record all financial transactions to the general ledger systems or have adequate beginning balance and year-end close out procedures. The Coast Guard did not have effective policies and procedures to identify the cause and resolve abnormal balances and account relationship discrepancies, e.g. budgetary to proprietary reconciliations. The Coast Guard did not have a process to track and reconcile intragovernmental transactions with its Federal trading partners, and to determine that Coast Guard intragovernmental balances are complete and accurate.	**Repeated** (Exhibit I-A)

V.1

	Summary of Conditions As Reported in 2007 DHS Performance and Accountability Report	Fiscal Year 2008 Status/ Disposition
B.2	DHS HQ did not fully implement a consolidated financial reporting process, including establishing the accounting, reporting, and data gathering responsibilities for the newly established Office of Health Affairs (OHA) in a timely manner, timely or completely reconciling intragovernmental balances with other Federal entities. DHS HQ had not fully implemented recently issued policies, and weaknesses were noted in the beginning of the year balance reconciliations, interim financial statement preparation and support, and computation of abnormal or unusual account balances, including proprietary to budgetary account relationship analysis performed at the consolidated level. DHS HQ did not always perform key supervisory and monitoring control procedures over work prepared by accounting staff during the year. DHS HQ had not established Strategic Goals and the financial information systems or sufficiently documented processes to accumulate cost data by strategic goal as required by SFFAS No. 4, and did not have a current strategic plan as required by GPRA.	**Corrected**
B.3	TSA made a number of restatements to its prior year financial statements, did not have certain policies and procedures in place all fiscal year, required numerous other on-top adjustments to properly close and report its monthly and annual financial results, did not consistently reverse all on-top adjustments that required reversal, and did not record all on-top adjustments properly. TSA required significant additional human resources to perform its year-end general ledger close, prepare financial statements, and respond to audit inquiries in a timely manner.	**Partially Repeated** (Exhibit II-A)
C.	**Financial Systems Security**	
	OCFO and DHS components have IT and financial system security control weaknesses in entity-wide security program planning and management, access controls, change controls, system software, segregation of duties, and service continuity.	**Partially Repeated** (Exhibits I-B and II-B)
D.	**Fund Balance with Treasury (FBwT)**	
	The Coast Guard did not effectively manage its suspense accounts to include supporting suspense account transactions and producing complete and accurate populations, and did not maintain adequate supporting documentation that validated the accuracy of the FBwT reconciliations and the clearing of suspense items. The Coast Guard was unable to provide validated military and civilian payroll data to support payroll transactions processed through the FBwT account.	**Repeated** (Exhibit I-C)

	Summary of Conditions As Reported in 2007 DHS Performance and Accountability Report	Fiscal Year 2008 Status/ Disposition
E.	**Capital Assets**	
E.1	The Coast Guard had not consistently applied policies and procedures to ensure appropriate documentation is maintained to support Property Plant & Equipment (PP&E) acquisitions and their existence, and the methodologies and assumptions, to support the value of PP&E where documentation has not been maintained, has not been developed. The Coast Guard has not implemented appropriate controls to accurately, consistently, and timely record additions to PP&E and construction in process, transfers, disposals, and valuation and classification of repairable PP&E. The Coast Guard has not implemented accurate and complete asset identification, system mapping, and tagging processes for fixed assets, and has not properly accounted for some improvements and impairments to buildings and structures, capital leases, and selected useful lives. For Operating Materials and Supplies (OM&S), the Coast Guard has not implemented policies, procedures, and internal controls to support the assertions related to the OM&S account balances, or fully designed and implemented procedures over physical counts of OM&S. The Coast Guard has not properly identified recorded OM&S, or established processes and controls to fully support the calculated value of certain types of OM&S to approximate historical cost.	**Repeated** (Exhibit I-D)
E.2	FEMA did not fully adhere to its policies when performing its annual physical count of supplies inventory. Inventory counts were not fully reconciled to the inventory system, inventory counts were not conducted in a well-controlled environment, and in some cases, inventory in the system could not be located.	**Corrected**
E.3	TSA did not reconcile its PP&E subsidiary ledger to its general ledger consistently and timely throughout the year. TSA had not recorded depreciation on certain equipment using a method consistent with GAAP. TSA did not record PP&E purchases in an account compliant with the USSGL requirements of FFMIA, and improperly capitalized certain advance payments to vendors as construction in progress.	**Partially Repeated** (Exhibit II-D)
E.4	US-Visit did not consistently apply procedures to identify and capitalize software development costs or to reclassify software placed into production. US-Visit does not have a reliable financial accounting and reporting process or system in place to routinely account for its software expenditures, capitalize appropriate amounts, and report those balances to DHS OFM.	**Corrected**

	Summary of Conditions As Reported in 2007 DHS Performance and Accountability Report	Fiscal Year 2008 Status/ Disposition
F.	**Actuarial and Other Liabilities**	
F.1	The Coast Guard did not have an effective process to ensure the completeness and accuracy of data provided to, and used by, the actuary for the calculation of the Military Retirement System pension, medical, and postemployment benefit liabilities, and reconciliations between subsidiary and general ledgers for medical expenditures were not effective. The Coast Guard did not have an effective process for reconciling military payroll recorded in CAS to detail payroll records. Military personnel data changes are not processed in the appropriate payroll and/or reporting periods, and consequently impact the completeness and accuracy of leave and payroll accruals as well as data used for actuarial projections. The Coast Guard did not have a reliable methodology to estimate accounts payable or legal liabilities. The Coast Guard did not support the completeness, existence, and accuracy assertions of the data utilized in developing the environmental liability estimate.	**Repeated** (Exhibit I-E)
F.2	FEMA did not establish a reliable method to estimate G&T grants payable (or advances). FEMA did not have sufficient policies and procedures in place to fully comply with the *Single Audit Act Amendments of 1996* and related OMB Circular No. A-133, *Audits of States, Local Governments, and Nonprofit Organizations.*	**Partially Repeated** (Exhibit II-E)
F.3	TSA had not maintained all necessary supporting documentation over accrued annual leave. TSA had not reconciled annual leave balances earned by employees per the payroll provider's output records to the data submitted by TSA and with the general ledger on a routine basis.	**Corrected**
G	**Budgetary Accounting**	
G.1	The Coast Guard did not have effective policies, procedures and internal controls over Coast Guard's process for validation and verification of UDO balances to ensure that recorded obligations were valid, accurate, recorded timely, and that proper approvals and supporting documentation is maintained. The Coast Guard had not implemented procedures and controls to prevent incurring a commitment/obligation in excess of established targets so that funds are not obligated in excess of the apportioned and allotted amounts, and did not effectively monitor unobligated commitment activity in its procurement system. The Coast Guard did not have properly designed and implemented procedures, processes, and internal controls to verify the completeness and accuracy of the year-end obligation pipeline adjustment to record all executed obligations. Automated system controls were not effectively used to prevent the processing of procurement transactions by contracting officers with expired warrant authority, and the listings of warranted contracting officers were not complete.	**Repeated** (Exhibit I-F)

	Summary of Conditions As Reported in 2007 DHS Performance and Accountability Report	Fiscal Year 2008 Status/ Disposition
G.2	FEMA did not adequately monitor the status of its obligations and ensure the timely deobligation of mission assignments. In addition, Other Federal Agencies (OFA) did not always provide FEMA with timely progress reports that included sufficient cost/billing data and sufficient documentation of mission assignment manager follow-up procedures with the OFAs was not obtained and/or documented timely.	**Repeated** (Exhibit II-F)
G.3	TSA did not have a funds control process in place to monitor outstanding obligation balances on a periodic basis. TSA did not have sufficient policies and procedures requiring contract officers to monitor and close-out contracts, and deficiencies were noted in the validation and verification process conducted over obligations. TSA completed an investigation over certain obligations recorded in previous years and determined that a violation of the *Anti-deficiency Act* occurred in previous years.	**Corrected**
Other Significant Deficiencies:		
H.	**Custodial Revenue and Drawback**	
H.1	The CBP Automated Commercial System (ACS) lacked automated controls to detect and prevent excessive drawback claims and overpayments, necessitating inefficient manual processes that do not effectively compensate for these automated controls. The CBP's drawback review policies did not require drawback specialists to review all or a statistically valid sample of related drawback claims against the underlying consumption entries to determine whether, in the aggregate, an excessive amount was claimed. The policies, procedures, and general guidance provided to field offices for the monthly review of the entry process needed improvement. There were inconsistencies in the performance of risk assessments and compliance reviews of Bonded Warehouses and Foreign Trade Zones, and in-bond entries in various ports. CBP was unable to determine the status of the in-bond shipments with the information available within ACS.	**Repeated** (Exhibit III-H)

Independent Auditors' Report
Exhibit V – Status of Prior Year Findings

Summary of Conditions As Reported in 2007 DHS Performance and Accountability Report	Fiscal Year 2008 Status/ Disposition
Compliance and Other Matters:	
I. *Federal Managers' Financial Integrity Act of 1982*	
The Coast Guard had not fully established effective systems, processes, policies, and procedures to develop and implement internal accounting and administrative controls and conformance of accounting systems. In addition, TSA and FEMA's control assessment processes require improvement to ensure full compliance with FMFIA.	**Repeated** (Exhibit IV-J)
J. *Federal Financial Management Improvement Act of 1996*	
We noted that DHS and each significant component did not fully comply with at least one of the requirements of FFMIA. In addition, we noted weaknesses in financial systems security, which impact the Department's ability to fully comply with FISMA.	**Repeated** (Exhibit IV-K)
K. ***Single Audit Act Amendments of 1996,* and Laws and Regulations Supporting OMB Circular No. A-50, *Audit Follow-up,* as revised**	
DHS and its components did not have procedures in place to fully comply with provisions in OMB Circular No. A-133 that require them to timely obtain and review grantee Single Audit reports and follow up on questioned costs and other matters identified in these reports. DHS and its components did not fully implement corrective action plans to address all material weaknesses and significant deficiencies identified by previous financial statement audits within the time-frames established in OMB Circular No. A-50.	**Repeated** (Exhibit IV-L)
L. *Improper Payments Information Act of 2002*	
DHS did not properly include all federal disbursements, some programs identified as high risk were not tested while others identified as low risk were tested, testing time frames selected for some components were not approved by OMB in advance, and corrective action plans were not developed for all programs identified as high risk during the risk assessment process if no statistical sampling was performed to validate those risks.	**Partially Repeated** (Exhibit IV-M)

V.6

Independent Auditors' Report
Exhibit V – Status of Prior Year Findings

Summary of Conditions As Reported in 2007 DHS Performance and Accountability Report	Fiscal Year 2008 Status/ Disposition
M. ***DHS Financial Accountability Act of 2004 (Chief Financial Officers Act of 1990)***	
The *DHS Financial Accountability Act of 2004* made DHS subject to the *Chief Financial Officers Act of 1990*, as amended, which requires DHS to submit to the Congress and OMB audited financial statements annually. DHS engaged an independent auditor to audit the September 30, 2007, consolidated balance sheet and statement of custodial activity only.	**Repeated** (Exhibit IV-N)
N. ***Government Performance and Results Act of 1993***	
DHS' Strategic Plan expired on October 1, 2006 and the Department had not yet provided an updated Strategic Plan. The existing (expired) strategic plan did not align all strategic objectives to performance objectives as required.	**Partially Repeated** (Exhibit IV-O)
O. ***The Debt Collection Improvement Act of 1996***	
DHS did not perform due process in a timely manner to ensure that some eligible debts are forwarded to the Treasury for cross-servicing or the offset program within the timeframes established by DCIA.	**Repeated** (Exhibit IV-P)
P. ***Anti-deficiency Act***	
DHS, specifically TSA, violated the *Anti-deficiency Act* in fund 70X0508 in an amount up to $155 million, where expenditures and obligations exceeded available funding in FY 2004. The DHS Secretary had reported the violation to the President of the United States, the Head of the Senate, the Speaker of the House of Representatives, and the Comptroller General, as required by 31 U.S.C. Section 1351. A separate notification of the final determination was still required under 31 U.S.C. Section 1351.	**Corrected** (Exhibit IV-Q)

Office of the Chief Financial Officer
U.S. Department of Homeland Security
Washington, DC 20528

Homeland Security

November 12, 2008

MEMORANDUM FOR: Richard L. Skinner
Inspector General

FROM: David L. Norquist
Chief Financial Officer

SUBJECT: Fiscal Year (FY) 2008 Financial Statement Audit

Thank you for the opportunity to comment on the Independent Public Accountant's audit of our balance sheets as of September 30, 2008 and 2007, and the related statement of custodial activities. We agree with the Independent Public Accountant's conclusions.

Although the report on internal controls and compliance indicates that DHS still faces serious financial management challenges, the auditor also acknowledges the significant progress made this year. Specifically, DHS reduced the number of audit qualifications from six to three, reduced material weaknesses from seven to six, and reduced the number of component conditions contributing to material weaknesses from 16 to 13. This progress was possible due to the efforts of many throughout the Department who worked to develop and implement meaningful corrective actions to strengthen financial management processes and internal controls.

The FY 2008 audit results show that our corrective actions are working, and we are already updating our plans to address issues identified by the auditors and our own A-123 assessment. Our plans will continue to focus both on sustaining progress, as well as supporting corrective actions in areas where weaknesses remain. This year, we have expanded our plans to include developing and implementing action plans to remediate areas identified as internal control significant deficiencies.

Financial management at DHS has come a long way and I continue to be inspired by the dedication and extraordinary efforts of the Department's financial management community. I would also like to thank you for your efforts and the dedication shown by your staff and the Independent Public Accountant in working with the Department to improve financial management. I appreciate the partnership we have forged and I am confident that this partnership will allow DHS to continue to improve financial management in support of our important mission.

Appendix A
Report Distribution

Department of Homeland Security

Secretary
Deputy Secretary
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Director, GAO/OIG Liaison Office
Assistant Secretary for Policy
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Chief Financial Officer
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Congressional Oversight and Appropriations Committees, as appropriate

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• Call our Hotline at 1-800-323-8603;

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• Email us at DHSOIGHOTLINE@dhs.gov; or

• Write to us at:
DHS Office of Inspector General/MAIL STOP 2600,
Attention: Office of Investigations - Hotline,
245 Murray Drive, SW, Building 410,
Washington, DC 20528.

The OIG seeks to protect the identity of each writer and caller.

Financial Statements

Department of Homeland Security
Balance Sheets
As of September 30, 2008 and 2007
(In Millions)

	2008 (Unaudited)	2007 (Unaudited) (Restated)
ASSETS		
Intragovernmental		
Fund Balance with Treasury (Notes 2 and 3)	$63,157	$56,185
Investments, Net (Note 5)	3,103	2,778
Accounts Receivable (Note 6)	310	279
Other (Note 13)		
Advances and Prepayments	2,852	2,887
Due from Treasury (Note 2)	151	176
Total Intragovernmental	**$69,573**	**$62,305**
Cash and Other Monetary Assets (Notes 2 and 4)	67	321
Accounts Receivable, Net (Notes 2 and 6)	488	760
Taxes, Duties, and Trade Receivables, Net (Notes 2 and 7)	2,078	1,937
Direct Loans, Net (Note 8)	21	-
Inventory and Related Property, Net (Note 9)	518	632
General Property, Plant, and Equipment, Net (Note 11)	14,501	12,602
Other (Note 13)		
Advances and Prepayments	649	567
TOTAL ASSETS	**$87,895**	**$79,124**
Stewardship Property, Plant, and Equipment (Note 12)		
LIABILITIES		
Intragovernmental		
Accounts Payable (Note 3)	$1,989	$2,262
Debt (Note 15)	17,719	18,153
Other (Note 18)		
Due to the General Fund	2,397	2,085
Accrued FECA Liability	361	355
Other	394	245
Total Intragovernmental	**$22,860**	**$23,100**
Accounts Payable	2,914	2,982
Federal Employee and Veterans' Benefits (Note 16)	36,230	34,910
Environmental and Disposal Liabilities (Note 17)	288	275
Other (Notes 18, 19, 20, and 21)		
Accrued Payroll and Benefits	1,787	1,553
Deferred Revenue and Advances from Others	3,080	2,727
Unliquidated Antidumping and Countervailing Duties	161	514
Insurance Liabilities	5,531	1,508

Department of Homeland Security
Balance Sheets
As of September 30, 2008 and 2007
(In Millions)

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Refunds and Drawbacks	130	131
Other	1,434	1,497
Total Liabilities	**$74,415**	**$69,197**
Commitments and contingencies (Notes 19, 20, and 21)		
NET POSITION (Note 35)		
Unexpended Appropriations		
Unexpended Appropriations-Other Funds	$55,228	$48,810
Cumulative Results of Operations		
Cumulative Results of Operations-Earmarked Funds (Note 22)	(19,337)	(16,236)
Cumulative Results of Operations-Other Funds	(22,411)	(22,647)
Total Net Position	**$13,480**	**$9,927**
TOTAL LIABILITIES AND NET POSITION	**$87,895**	**$79,124**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Net Cost
For the Years Ended September 30, 2008 and 2007
(In Millions)

Directorates and Other Components (Note 23 and 24)	**2008 (Unaudited)**	**2007 (Unaudited) (Restated)**
U.S. Customs and Border Protection		
Gross Cost	$9,783	$8,198
Less Earned Revenue	(160)	(157)
Net Cost	**9,623**	**8,041**
U.S. Coast Guard		
Gross Cost	9,508	10,653
Less Earned Revenue	(465)	(492)
Net Cost	**9,043**	**10,161**
U.S. Citizenship and Immigration Services		
Gross Cost	2,184	1,731
Less Earned Revenue	(2,215)	(1,659)
Net Cost	**(31)**	**72**
Federal Emergency Management Agency		
Gross Cost	18,500	14,272
Less Earned Revenue	(3,027)	(2,842)
Net Cost	**15,473**	**11,430**
Federal Law Enforcement Training Center		
Gross Cost	447	402
Less Earned Revenue	(40)	(41)
Net Cost	**407**	**361**
National Protection and Programs Directorate		
Gross Cost	872	855
Less Earned Revenue	(1)	-
Net Cost	**871**	**855**
U.S. Immigration and Customs Enforcement		
Gross Cost	5,485	4,891
Less Earned Revenue	(928)	(900)
Net Cost	**4,557**	**3,991**

Department of Homeland Security
Statements of Net Cost
For the Years Ended September 30, 2008 and 2007
(In Millions)

Directorates and Other Components (Note 23 and 24)	**2008 (Unaudited)**	**2007 (Unaudited) (Restated)**
Office of Health Affairs		
Gross Cost	157	113
Less Earned Revenue	-	-
Net Cost	**157**	**113**
Departmental Operations and Other		
Gross Cost	1,316	1,204
Less Earned Revenue	(1)	(3)
Net Cost	**1,315**	**1,201**
U.S. Secret Service		
Gross Cost	1,747	1,689
Less Earned Revenue	(11)	(16)
Net Cost	**1,736**	**1,673**
Science and Technology Directorate		
Gross Cost	776	987
Less Earned Revenue	(6)	(14)
Net Cost	**770**	**973**
Transportation Security Administration		
Gross Cost	6,622	6,356
Less Earned Revenue	(2,385)	(2,299)
Net Cost	**4,237**	**4,057**
NET COST OF OPERATIONS (Note 23 and 24)	**$48,158**	**$42,928**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Changes in Net Position
For the Year Ended September 30, 2008
(In Millions)

	Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
	2008 (Unaudited)			
Cumulative Results of Operations				
Beginning Balances	$(16,236)	$(22,647)	$ -	$(38,883)
Budgetary Financing Sources				
Appropriations used	-	41,062	-	41,062
Non-exchange Revenue	3,823	6	-	3,829
Donations and Forfeitures of Cash and Cash Equivalents	2	-	-	2
Transfers in/out Without Reimbursement	(2,123)	1,854	-	(269)
Other	-	(38)	-	(38)
Other Financing Sources (Non-Exchange)				
Donations and forfeitures of property	-	14	-	14
Transfers in/out reimbursement	(43)	61	-	18
Imputed financing	2	751	15	738
Other	-	(63)	-	(63)
Total Financing Sources	1,661	43,647	15	45,293
Net Cost of Operations	(4,762)	(43,411)	(15)	(48,158)
Net Change	(3,101)	236	-	(2,865)
Cumulative Results of Operations	**(19,337)**	**(22,411)**	**-**	**(41,748)**
Unexpended Appropriations				
Beginning Balance	-	48,810	-	48,810
Adjustments:				
Adjustments (Note 35)	-	(1,468)	-	(1,468)
Beginning Balance, as Adjusted	**-**	**47,342**	**-**	**47,342**
Budgetary Financing Sources				
Appropriations Received (Note 31)	-	50,253	-	50,253
Appropriations Transferred in/out	-	(683)	-	(683)
Other Adjustments	-	(622)	-	(622)
Appropriations Used	-	(41,062)	-	(41,062)
Total Budgetary Financing Sources	-	7,886	-	7,886
Total Unexpended Appropriations	**-**	**55,228**	**-**	**55,228**
NET POSITION	**$(19,337)**	**$32,817**	**$ -**	**$13,480**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Changes in Net Position
For the Year Ended September 30, 2007
(In Millions)

	2007 (Unaudited) (Restated)			
	Earmarked Funds	All Other Funds	Eliminations	Consolidated Total
Cumulative Results of Operations				
Beginning Balances	$(18,644)	$(20,919)	$ -	$(39,563)
Adjustments:				
Correction of Errors (Note 33)	-	266	-	266
Beginning Balance, as Adjusted	**(18,644)**	**(20,653)**	-	**(39,297)**
Budgetary Financing Sources				
Appropriations used	-	39,178	-	39,178
Non-exchange Revenue	3,603	6	-	3,609
Donations and Forfeitures of Cash and Cash Equivalents	2	-	-	2
Transfers in/out Without Reimbursement	(1,980)	1,855	-	(125)
Other	-	(174)	-	(174)
Other Financing Sources (Non-Exchange)				
Donations and forfeitures of property	-	4	-	4
Transfers in/out reimbursement	-	9	-	9
Imputed financing	2	848	11	839
Total Financing Sources	1,627	41,726	11	43,342
Net Cost of Operations	781	(43,720)	(11)	(42,928)
Net Change	2,408	(1,994)	-	414
Cumulative Results of Operations	**(16,236)**	**(22,647)**	-	**(38,883)**
Unexpended Appropriations				
Beginning Balance	-	48,853	-	48,853
Adjustments:				
Corrections of Errors (Note 33)		(89)		(89)
Beginning Balance, as Adjusted	-	**48,764**	-	**48,764**
Budgetary Financing Sources				
Appropriations Received (Note 31)	-	39,520	-	39,520
Appropriations Transferred in/out	-	295	-	295
Other Adjustments	-	(591)	-	(591)
Appropriations Used	-	(39,178)	-	(39,178)
Total Budgetary Financing Sources	-	46	-	46
Total Unexpended Appropriations	-	**48,810**	-	**48,810**
NET POSITION	**$(16,236)**	**$26,163**	**$ -**	**$9,927**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Budgetary Resources
For the Years Ended September 30, 2008 and 2007
(In Millions)

	2008 (Unaudited)		2007 (Unaudited) (Restated)	
	Budgetary	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**
BUDGETARY RESOURCES				
Unobligated Balance, Brought Forward, October 1 (Note 35)	$17,214	$131	$17,309	$ -
Recoveries of Prior Year Unpaid Obligations	3,824	-	4,997	-
Budget Authority:				
Appropriations (Note 31)	57,653	-	46,491	-
Spending Authority from Offsetting Collections:				
Earned:				
Collected	9,450	172	9,963	336
Change in Receivables from Federal Sources	(19)	-	7	-
Change in Unfilled Customer Orders:				
Advances Received	84	-	78	-
Without Advance From Federal Sources	(350)	(37)	696	(122)
Expenditure Transfers from Trust Funds	48	-	47	-
Subtotal	66,866	135	57,282	214
Non-expenditure Transfers, net; Anticipated and Actual	(210)	-	787	-
Temporarily Not Available Pursuant to Public Law	(14)	-	-	-
Permanently Not Available	(883)	(251)	(671)	(70)
TOTAL BUDGETARY RESOURCES	**$86,797**	**$15**	**$79,704**	**$144**
STATUS OF BUDGETARY RESOURCES				
Obligations Incurred: (Note 25)				
Direct	$56,814	$11	$56,653	$13
Reimbursable	8,664	-	5,320	-
Subtotal	65,478	11	61,973	13
Unobligated Balance:				
Apportioned	7,224	4	9,157	12
Exempt from Apportionment	91	-	97	-
Subtotal	7,315	4	9,254	12
Unobligated Balance Not Available	14,004	-	8,477	119
TOTAL STATUS OF BUDGETARY RESOURCES	**$86,797**	**$15**	**$79,704**	**$144**

Department of Homeland Security
Statements of Budgetary Resources
For the Years Ended September 30, 2008 and 2007
(In Millions)

	2008 (Unaudited)		2007 (Unaudited) (Restated)	
	Budgetary	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**
CHANGE IN OBLIGATED BALANCE				
Obligated Balance, Net				
Unpaid Obligations Brought Forward, October 1 (Note 35)	$42,753	$480	$43,040	$642
Uncollected Customer Payments from Federal Sources, Brought Forward, October 1	(2,770)	(361)	(2,069)	(482)
Total Unpaid Obligated Balance, net	39,983	119	40,971	160
Obligations Incurred, net	65,478	11	61,973	13
Gross Outlays	(57,191)	(168)	(56,293)	(175)
Obligated Balance Transferred, net				
Actual Transfers, Unpaid Obligations	(25)	-	(18)	-
Total Unpaid Obligated Balance Transferred, net	(25)	-	(18)	-
Recoveries of Prior Year Unpaid Obligations, Actual	(3,824)	-	(4,997)	-
Change in Uncollected Customer Payments from Federal Sources	367	38	(702)	121
Obligated Balance, net, End of Period				
Unpaid Obligations	47,191	323	43,704	480
Uncollected Customer Payments from Federal Sources	(2,403)	(323)	(2,770)	(361)
Total, Unpaid Obligated Balance, net, End of Period	**$44,788**	**$ -**	**$40,934**	**$119**
NET OUTLAYS				
Gross Outlays	$57,191	$168	$56,293	$175
Offsetting Collections	(9,582)	(172)	(10,090)	(336)
Distributed Offsetting Receipts	(6,048)	-	(4,952)	-
NET OUTLAYS	**$41,561**	**$(4)**	**$41,251**	**$(161)**

The accompanying notes are an integral part of these statements.

Department of Homeland Security
Statements of Custodial Activity
For the Years Ended September 30, 2008 and 2007
(In Millions)

	2008 (Unaudited)	2007 (Unaudited)
Revenue Activity		
Sources of Cash Collections:		
Duties	$27,320	$26,658
User Fees	1,796	1,732
Excise Taxes	2,457	2,626
Fines and Penalties	89	60
Interest	26	15
Miscellaneous	149	25
Total Cash Collections	31,837	31,116
Accrual Adjustments	133	5,723
Total Custodial Revenue	**31,970**	**36,839**
Disposition of Collections		
Transferred to Others:		
Federal Entities:		
U.S. Department of Agriculture	8,258	148
U.S. Department of Labor	87	193
U.S. Department of State	45	46
National Science Foundation	104	107
Treasury General Fund Accounts	20,973	23,591
Other Federal Agencies	23	21
Non-Federal Entities:		
Government of Puerto Rico	12	14
Government of the U.S. Virgin Islands	2	5
Other Non-Federal Entities	875	20
(Increase)/Decrease in Amounts Yet to be Transferred	237	5,712
Refunds and Drawbacks (Notes 18 and 32)	1,296	6,922
Retained by the Department	58	60
Total Disposition of Custodial Revenue	**31,970**	**36,839**
Net Custodial Activity	**$ -**	**$ -**

The accompanying notes are an integral part of these statements.

Notes to the Financial Statements (Unaudited)

Table of Contents for Notes to the Financial Statements (unaudited)

Notes to the Financial Statements (Unaudited)

1. Summary of Significant Accounting Policies

A. Reporting Entity

The Department of Homeland Security (DHS or the Department) was established by the *Homeland Security Act of 2002 (HSA), P.L. 107-296*, dated March 25, 2002, as an executive department of the U.S. Federal Government. DHS's mission is to lead the national effort to secure America. This mission includes the prevention and deterrence of terrorist attacks and protection against, and response to, threats and hazards to the Nation and critical infrastructure from dangerous people and goods. Additionally, DHS's mission is to ensure the safety and security of borders, welcome lawful immigrants and visitors, and promote the free-flow of commerce. In support of DHS's mission, the Secretary has established additional goals to build a nimble, effective emergency response system and a culture of preparedness, and to strengthen and unify DHS operations and management. The Department is composed of the following financial reporting Components[1]:

- **U.S. Customs and Border Protection (CBP)**
- **U.S. Coast Guard (USCG)**
- **U.S. Citizenship and Immigration Services (USCIS)**
- **Federal Emergency Management Agency (FEMA)**
- **Federal Law Enforcement Training Center (FLETC)**
- **National Protection and Programs Directorate (NPPD)**
- **U.S. Immigration and Customs Enforcement (ICE),** including the Federal Protective Services (FPS)
- **Office of Health Affairs (OHA)**
- **Departmental Operations and Other**, including the Management Directorate (MGMT), the Office of the Secretary, the Office of the Inspector General (OIG), the Domestic Nuclear Detection Office (DNDO), Office of Intelligence and Analysis, and the Office of Operations Coordination and Planning
- **U.S. Secret Service (USSS)**
- **Science and Technology Directorate (S&T)**
- **Transportation Security Administration (TSA)**

B. Basis of Presentation

These financial statements are prepared to report the consolidated financial position, net cost of operation, changes in net position, custodial activity, and the combined budgetary resources of the Department pursuant to the *Government Management Reform Act of 1994 (P.L. 103-356)* and *Chief Financial Officers Act of 1990 (P.L 101-576)*, as amended by the *Reports Consolidation Act of 2000 (P.L. 106-531)*.

The Department's financial statements have been prepared from the accounting records of the Department in conformity with U.S. Generally Accepted Accounting Principles (GAAP) and Office

[1] Financial reporting Components are to be distinguished from direct report Components.

of Management and Budget (OMB) Circular A-136, *Financial Reporting Requirements*. GAAP for Federal entities are the standards prescribed by the Federal Accounting Standards Advisory Board (FASAB), the official accounting standards-setting body of the Federal Government.

The Department's financial statements reflect the reporting of Departmental activities including appropriations received to conduct operations and revenue generated from operations. The financial statements also reflect the reporting of certain non-entity (custodial) functions performed by the Department on behalf of the Federal Government.

Intragovernmental assets and liabilities result from activity with other Federal entities. All other assets and liabilities result from activity with parties outside the Federal Government, such as domestic and foreign persons, organizations, or governments. Intragovernmental earned revenues are collections or accruals of revenue from other Federal entities and intragovernmental costs are payments or accruals to other Federal entities. Transactions and balances among the Department's Components have been eliminated in the consolidated presentation of the Balance Sheets, Statements of Net Cost, Statements of Changes in Net Position, and the Statements of Custodial Activity. The Statements of Budgetary Resources are reported on a combined basis; therefore, intradepartmental balances have not been eliminated.

While these financial statements have been prepared from the books and records of the Department in accordance with the formats prescribed by OMB, these financial statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.

These financial statements should be read with the realization that they are for a component of the U.S. Government, a sovereign entity, whose liabilities not covered by budgetary resources cannot be liquidated without the enactment of an appropriation, and that the payment of all liabilities other than for contracts can be abrogated by the U.S. Government acting in its capacity as a sovereign entity.

C. Basis of Accounting

Transactions are recorded on an accrual and a budgetary basis of accounting. Under the accrual basis, revenues are recorded when earned and expenses are recognized when a liability is incurred, regardless of when cash is exchanged. Budgetary accounting facilitates compliance with legal constraints and the controls over the use of Federal funds. The balances and activity of budgetary accounts are used to prepare the Statements of Budgetary Resources. The Statements of Custodial Activity are reported using the modified cash basis. With this method, revenue from cash collections is reported separately from receivable accruals and cash disbursements are reported separately from payable accruals.

D. Use of Estimates

Management has made certain estimates and assumptions in the reporting of the financial statement balances and associated disclosures. Actual results could differ from these estimates. Significant estimates include: the year-end accruals of accounts and grants payable; contingent legal and environmental liabilities; accrued workers' compensation; allowance for doubtful accounts receivable; allowances for obsolete inventory and operating materials and supplies (OM&S) balances; allocations of indirect common costs to construction-in-progress; depreciation; subsidy re-estimates; deferred revenues; National Flood Insurance Program (NFIP) insurance liability; actuarial workers compensation assumptions; military and other pension, retirement and post-retirement benefit assumptions; allowances for doubtful duties, fines, penalties, and certain non-entity receivables; and payables related to custodial activities and undeposited collections.

E. Entity and Non-Entity Assets

Entity assets are assets that the Department has the authority to use in its operations. The authority to use funds in an entity's operations means that Department management has the authority to decide how funds are used, or management is legally obligated to use funds to meet entity obligations, e.g. salaries and benefits.

Non-entity assets are assets held by the Department, but are not available for use by the Department. An example of a non-entity asset is the portion of Fund Balance with Treasury which consists of special and deposit funds, permanent appropriations, and miscellaneous receipts that are available to pay non-entity liabilities.

F. Fund Balance with Treasury

Fund Balance with Treasury represents the aggregate amount of the Department's accounts with the U.S. Department of the Treasury (Treasury) available to pay current liabilities and finance authorized purchases, except as restricted by law. The Department's Fund Balance with Treasury balances are primarily appropriated, revolving, trust, deposit, receipt, and special fund amounts remaining as of the fiscal year-end.

For additional information, see Note 3, Fund Balance with Treasury.

G. Cash and Other Monetary Assets

The Department's cash and other monetary assets primarily consist of undeposited collections, imprest funds, cash used in undercover operations, cash held as evidence, cash held by insurance companies, and seized cash and monetary instruments.

The Department does not maintain cash in commercial bank accounts. For FEMA, certain receipts are received and processed by insurance companies. The remainder of the receipts and disbursements are processed by Treasury.

For additional information, see Note 4, Cash and Other Monetary Assets.

H. Investments, Net

Investments consist of U.S. Government non-marketable par value and market based Treasury securities, and are reported at cost or amortized cost net of premiums or discounts. Premiums or discounts are amortized into interest income over the terms of the investment using the effective interest method or the straight line method, which approximates the interest method. No provision is made for unrealized gains or losses on these securities because it is the Department's intent to hold these investments to maturity.

For additional information, see Note 5, Investments, Net.

I. Accounts Receivable, Net

Accounts receivable represent amounts due to the Department from other Federal agencies and the public. Intragovernmental accounts receivable generally arise from the provision of goods and services to other Federal agencies and are expected to be fully collected.

Accounts receivable due from the public typically results from various immigration and user fees, premiums and restitution from insurance companies and policyholders, breached bonds, reimbursable services, and security fees. Public accounts receivable are presented net of an allowance for doubtful accounts, which is based on analyses of debtors' ability to pay, specific identification of probable losses, aging analysis of past due receivables, or historical collection experience. Interest due on past due receivables is fully reserved until collected.

For additional information, see Note 6, Accounts Receivable, Net.

J. Advances and Prepayments

Intragovernmental advances, presented as a component of other assets in the accompanying Balance Sheets, consist primarily of disaster recovery and assistance advances to other Federal agencies tasked with mission assignments.

Advances and prepayments to the public, presented as a component of other assets in the accompanying Balance Sheets, consist primarily of disaster recovery and assistance grants to States and other grant activity. Advances are expensed as they are used by the recipients.

For additional information, see Note 13, Other Assets.

K. Direct Loans, Net

Direct loans are loans issued by the Department to local governments. FEMA, the only DHS Component with loan activity, operates the Community Disaster Loan program to support any local government which has suffered a substantial loss of tax and other revenues as a result of a major disaster and which demonstrates a need for Federal financial assistance in order to perform its governmental functions. Under the program, FEMA transacts direct loans to local governments who meet statutorily set eligibility criteria. Loans are accounted for as receivables as funds are disbursed.

All of the Department's loans are post-1991 obligated direct loans, and the resulting receivables are governed by the *Federal Credit Reform Act of 1990 (FCRA) (P.L. 101-508).* Under FCRA, for direct loans disbursed during a fiscal year, the corresponding receivable is adjusted for subsidy costs. Subsidy costs are an estimated long-term cost to the U.S. Government for its loan programs. The subsidy cost is equal to the present value of the estimated cash outflows over the life of the loans minus the present value of the estimated cash inflows, discounted at the applicable Treasury interest rate. Administrative costs such as salaries and contractual fees are not included. Subsidy costs can arise from interest rate differentials, interest subsidies, delinquencies and defaults, and other cash flows. The Department calculates the subsidy costs based on a subsidy calculator model created by OMB.

Loans receivable are recorded at the present value of the estimated net cash flows. The difference between the outstanding principal of the loans and the present value of their net cash inflows is recorded in the allowance for subsidy, which is estimated and adjusted annually, as of year-end. Interest receivable is the total interest that has accrued on each of the outstanding loans, less any cancellations that may have been recorded due to the FEMA cancellation policy as described in 44 CFR Section 206.366.

For additional information see Note 8, Direct Loans, net.

L. Inventory and Related Property, Net

Operating Materials and Supplies (OM&S) are tangible personal property consumed during normal operations. Department OM&S consists primarily of goods consumed during the service of vessels and aircraft. OM&S are valued based on an average unit cost, weighted moving average method, or on actual prices paid. OM&S are expensed when consumed or issued for use. Excess, obsolete, and unserviceable OM&S are stated at net realizable value net of an allowance, which is based on the condition of various asset categories, as well as historical experience with using and disposing of such assets.

Inventory is tangible personal property that is held for sale or used in the process of production for sale. Department inventories consist primarily of the U.S. Coast Guard Supply Fund, providing uniform clothing, subsistence provisions, retail stores, technical material and fuel, and the U.S. Coast Guard Industrial Fund, providing inventory for the repair of U.S. Coast Guard and other government agency ships and vessels. Inventories on hand at year-end are stated at cost using standard price/specific identification, first-in/first-out, last acquisition price, or weighted average cost methods, which approximates historical cost. Revenue on inventory sales and associated cost of goods sold are recorded when merchandise is sold to the end user.

Stockpile materials are critical materials held due to statutory requirements for use in national emergencies. The Department's stockpile materials held by FEMA include goods that would be used to respond to national disasters, including water, meals, cots, blankets, tarps, and blue roof sheeting. Inventory at year-end is stated at historical cost using the weighted average method.

For additional information see Note 9, Inventory and Related Property, Net

M. Seized and Forfeited Property

The Department's prohibited seized property results primarily from criminal investigations and passenger/cargo processing. Seized property falls into two categories, prohibited and non-prohibited. Prohibited seized property includes illegal drugs, contraband, and counterfeit items that cannot legally enter into the commerce of the United States; non-prohibited seized property includes items that are not inherently illegal to possess or own such as monetary instruments, real property, and tangible personal property of others.

Seized property is not considered an asset of the Department and is not reported as such in the Department's financial statements. However, the Department has a stewardship responsibility until the disposition of the seized items are determined, i.e., judicially or administratively forfeited or returned to the entity from which it was seized.

Forfeited property is seized property for which the title has passed to the U.S. Government. Prohibited forfeited items such as counterfeit goods, narcotics, or firearms are held by the Department until disposed of or destroyed. Non-prohibited forfeited property is transferred to the Treasury Forfeiture Fund.

An analysis of changes in seized and forfeited property of prohibited items is presented in Note 10.

N. General Property, Plant, and Equipment, Net

The Department's Property, Plant, and Equipment (PP&E) consists of aircraft, vessels, vehicles, land, structures, facilities, capital leases, leasehold improvements, software, information technology, and other equipment. PP&E is recorded at cost. The U.S. Coast Guard uses a market-based valuation method to record PP&E assets when the historical cost is unknown. For those assets that are unique and uncommon, formal appraisals are conducted to determine acquisition cost. The Department capitalizes PP&E acquisitions when the cost equals or exceeds an established threshold and has a useful life of two years or more.

Costs for construction projects are recorded as construction-in-progress until completed, and are valued at actual (direct) costs, plus applied overhead and other indirect costs. In cases where historical cost information was not maintained, PP&E is capitalized using an estimated cost based on the cost of similar assets at the time of acquisition or the current cost of similar assets discounted for inflation since the time of acquisition. The Department owns some of the buildings in which Components operate. Other buildings are provided by the General Services Administration (GSA), which charges rent equivalent to the commercial rental rates for similar properties.

Internal use software includes purchased commercial off-the-shelf software (COTS), contractor developed software, and internally developed software. For COTS software, the capitalized costs include the amount paid to the vendor for the software. For contractor developed software the capitalized costs include the amount paid to a contractor to design, program, install, and implement the software. Capitalized costs for internally developed software include the full cost (direct and indirect) incurred during the software development phase. Costs incurred during the preliminary design and post-implementation/operational phases are expensed in the period incurred. In addition, CBP applies capital lease accounting concepts to software license fee agreements that give CBP the "right to use" the software.

The schedule of capitalization thresholds shown below is a summary of the range of capitalization rules in place from the legacy agencies that comprised the Department. In accordance with DHS policy, Components were allowed to continue using their legacy thresholds and capitalization rules until a more comprehensive approach is developed that takes into account the vast differences in Component size and asset usage.

The ranges of capitalization thresholds and service life used by Components, by primary asset category, are as follows:

Asset Description	Capitalization Threshold	Service Life
Land	Zero to $200,000	Not Applicable
Improvements to Land	Zero to $200,000	2 years to 50 years
Buildings and improvement	Zero to $200,000	2 years to 50 years

Equipment and capital leases	$5,000 to $200,000	2 years to 57 years
Software	$50,000 to $750,000	2 or more years

The Department begins to recognize depreciation expense once the asset has been placed in service. Depreciation is calculated on a straight-line method for all asset classes over their estimated useful lives. Land is not depreciated. Leasehold improvements are depreciated over the shorter of the term of the remaining portion of the lease or the useful life of the improvement. Buildings and equipment acquired under capital leases are amortized over the lease term. Amortization of capitalized software is calculated using the straight-line method and begins on the date of acquisition if purchased, or when the module or component has been placed in use (i.e., successfully installed and tested) if contractor or internally developed. There are no restrictions on the use or convertibility of general PP&E.

For additional information see Note 11, General Property, Plant and Equipment, Net.

O. Stewardship Property, Plant and Equipment

Stewardship PP&E includes heritage assets and stewardship land which generally are not included in general PP&E presented on the Balance Sheet. Heritage assets are unique due to their historical or natural significance, cultural, educational, or artistic importance, or significant architectural characteristics. The Department's heritage assets consist primarily of historical artifacts, art work, buildings, and structures owned by the U.S. Coast Guard. The cost of improving, reconstructing or renovating heritage assets is recognized as an expense in the period incurred. Similarly, the cost to acquire or construct a heritage asset is recognized as an expense of the period incurred. Due to their nature, heritage assets are not depreciated because matching costs with specific periods would not be meaningful.

Heritage assets can serve two purposes: a heritage function and general government operational function. If a heritage asset serves both purposes, but is predominantly used for general government operations, the heritage asset is considered a multi-use heritage asset, which is included in general PP&E on the Balance Sheet. DHS depreciates its multi-use heritage assets over their useful life. The Department's multi-use heritage assets consist primarily of buildings and structures owned by CBP and the U.S. Coast Guard.

For more information see Note 12, Stewardship Property, Plant and Equipment.

P. Liabilities

Liabilities represent the probable and measurable future outflow or other sacrifice of resources as a result of past transactions or events. Liabilities covered by budgetary resources are those liabilities for which Congress has appropriated funds or funding is otherwise available to pay amounts due. Liabilities not covered by budgetary or other resources represent amounts owed in excess of available Congressionally appropriated funds or other amounts, and there is no certainty that the appropriations will be enacted. The U.S. Government, acting in its sovereign capacity, can abrogate liabilities of the Department arising from other than contracts.

Q. Contingent Liabilities

Certain conditions exist as of the date of the financial statements, which may result in a loss to the government, but which will only be resolved when one or more future events occur or fail to occur. The Department recognizes a loss contingency when the future outflow or other sacrifice of resources is probable and reasonably estimable. Loss contingencies that are determined by management to have a reasonably possible chance of occurring or that cannot be estimated are included as a footnote to the financial statements. Contingent liabilities considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee is disclosed.

For more information see Note 21, Commitments and Contingent Liabilities.

Environmental Cleanup Costs. Environmental liabilities consist of environmental remediation, cleanup, and decommissioning. The liability for environmental remediation is an estimate of costs necessary to bring a known contaminated asset into compliance with applicable environmental standards. Accruals for environmental cleanup costs are the costs of removing, containing, and/or disposing of hazardous wastes or materials that, because of quantity, concentration, or physical or chemical characteristics, may pose a substantial present or potential hazard to human health or the environment.

For all PP&E in service as of October 1, 1997, DHS recognizes the estimated total cleanup costs associated with the PP&E at the time the cleanup requirement is identified. DHS does not prorate a cleanup cost over the life of these PP&E. However, the estimate may be subsequently adjusted for material changes due to inflation/deflation or changes in regulations, plans, or technology. The applicable costs of decommissioning DHS's existing and future vessels are considered cleanup costs.

For more information see Note 17, Environmental and Disposal Liabilities.

R. Grants Liabilities

The Department awards grants and cooperative agreements to Federal, State, and local governments, universities, non-profit organizations, and private sector companies for the purpose of building the capacity to respond to disasters and emergencies, conduct research into preparedness, enhance and ensure the security of passenger and cargo transportation by air, land, or sea, and other Department-related activities. The Department estimates the year-end grant accrual for unreported grantee expenditures using historical disbursement data. Grants liabilities are combined with accounts payable to the public in the accompanying Balance Sheets.

S. Insurance Liabilities

Insurance liabilities are the result of the Department's sale or continuation-in-force of flood insurance known as the NFIP, which is managed by FEMA. The insurance liability represents an estimate of NFIP losses that are unpaid at the Balance Sheet date. Although the insurance underwriting operations believes the liability for unpaid losses and loss adjustment expenses is reasonable and adequate in the circumstances, actual incurred losses and loss adjustment expenses may not conform to the assumptions inherent in the estimation of the liability. Accordingly, the ultimate settlement of losses and the related loss adjustment expenses may vary from the estimate reported in the financial statements.

For more information see Note 18, Other Liabilities, and Note 20, Insurance Liabilities.

T. Debt and Borrowing Authority

Debt is reported within Intragovernmental Liabilities and results from Treasury loans and related interest payable to fund NFIP and Disaster Assistance Direct Loan Program (DADLP) operations. The Department's obligations for NFIP and DADLP are financed by principal repayments, flood premiums, and map collection fees.

The Department has borrowing authority for NFIP and DADLP, and may obtain additional borrowing authority if approved.

For more information see Note 15, Debt and Note 26, Available Borrowing Authority.

U. Accrued Payroll and Benefits

Accrued Payroll. Accrued Payroll consists of salaries, wages, and other compensation earned by the employees, but not disbursed as of September 30. The liability is estimated for reporting purposes based on historical pay information.

Leave Program. Earned annual and other vested compensatory leave is accrued as it is earned and reported on the Balance Sheet as an accrued payroll and benefits liability. The liability is reduced as leave is taken. Each year, the balances in the accrued leave accounts are adjusted to reflect the liability at current pay rates and leave balances. Sick leave and other types of non-vested leave are not earned benefits. Accordingly, non-vested leave is expensed when used.

Federal Employees Compensation Act. The *Federal Employees Compensation Act (FECA) (P.L. 103-3)* provides income and medical cost protection to covered Federal civilian employees injured on the job, to employees who have incurred work-related occupational diseases, and to beneficiaries of employees whose deaths are attributable to job-related injuries or occupational diseases. The FECA program is administered by the U.S. Department of Labor (DOL), which pays valid claims and subsequently seeks reimbursement from the Department for these paid claims.

The FECA liability consists of two components. The first component, accrued FECA liability, is based on actual claims paid by DOL but not yet reimbursed by the Department. The Department reimburses DOL for the amount of actual claims as funds are appropriated for this purpose. There is generally a two to three-year time period between payment by DOL and reimbursement to DOL by the Department. As a result, the Department recognizes an intragovernmental liability for the actual claims paid by DOL and to be reimbursed by the Department.

The second component, actuarial FECA liability, is the estimated liability for future benefit payments and is recorded as a component of Federal Employee and Veterans' Benefits. This liability includes death, disability, medical, and miscellaneous costs. DOL determines the actuarial FECA liability annually, as of September 30, using an actuarial method that considers historical benefit payment patterns, wage inflation factors, medical inflation factors, and other variables. The projected annual benefit payments are discounted to present value using the OMB economic assumptions for ten year Treasury notes and bonds. The actuarial FECA liability is not covered by budgetary resources and will require future funding.

For more information on the Actuarial FECA Liability see Note 16, Federal Employee and Veterans' Benefits. For more information on the Accrued FECA Liability, Accrued Payroll and Accrued Leave, see Note 18, Other Liabilities.

V. Federal Employee and Veterans' Benefits

Civilian Pension and Other Post Employment Benefits. The Department recognizes the full annual cost of its civilian employees' pension benefits; however, the assets of the plan and liability associated with pension costs are recognized by Office of Personnel Management (OPM) rather than the Department.

Most U.S. Government employees of DHS hired prior to January 1, 1984, participate in the Civil Service Retirement System (CSRS), to which the Department contributes 7 percent of base pay for regular CSRS employees, and 7.5 percent of base pay for law enforcement agents. The majority of employees hired after December 31, 1983, are covered by the Federal Employees Retirement System (FERS) and Social Security. For the FERS basic annuity benefit the Department contributes 11.2 percent of base pay for regular FERS employees and 24.9 percent for law enforcement agents. A primary feature of FERS is that it also offers a defined contribution plan (Federal Thrift Savings Plan) to which the Department automatically contributes 1 percent of base pay and matches employee contributions up to an additional 4 percent of base pay. The Department also contributes the employer's Social Security matching share for FERS participants.

Similar to CSRS and FERS, OPM rather than the Department reports the liability for future payments to retired employees who participate in the Federal Employees Health Benefits Program (FEHB) and Federal Employees Group Life Insurance Program (FEGLI). The Department is required to report the full annual cost of providing these other retirement benefits (ORB) for its retired employees as well as reporting contributions made for active employees. In addition, the Department recognizes an expense and liability for other post employment benefits (OPEB), which includes all types of benefits provided to former or inactive (but not retired) employees, their beneficiaries, and covered dependents.

The difference between the full annual cost of CSRS and FERS retirement, ORB, and OPEB and the amount paid by the Department is recorded as an imputed cost and offsetting imputed financing source in the accompanying financial statements.

Military Retirement System Liability. The U.S. Coast Guard Military Retirement System (MRS) is a defined benefit plan that covers both retirement pay and health care benefits for all retired active duty and reserve military members of the U.S. Coast Guard. The plan is a pay-as-you-go system funded through annual appropriations. The actuarial unfunded accrued liability reported on the accompanying Balance Sheet is determined by subtracting the sum of the present value of future employer normal costs, the present value of any expected future employee contributions and any plan assets, from the present value of the future benefits expected to be paid. The Normal Cost (current period expense) is computed using the individual entry age normal actuarial cost method.

A portion of the accrued MRS liability is for the health care of non-Medicare eligible and Medicare eligible retirees/survivors. The U.S. Department of Defense (DOD) is the administrative entity for the Medicare-Eligible Retiree Health Care Fund (MERHCF), and in accordance with Statement of

Federal Financial Accounting Standards (SFFAS) No. 5, *Accounting for Liabilities of the Federal Government*, is required to recognize the liability on the MERHCF's financial statements. The U.S. Coast Guard makes annual payments to the MERHCF for current active duty and reserve military members. Benefits for U.S. Coast Guard members who retired prior to the establishment of the MERHCF are provided by payments from the Treasury to the MERHCF. The future cost and liability of the MERHCF is determined using claim factors and claims cost data developed by DOD, adjusted for U.S. Coast Guard retiree and actual claims experience. The U.S. Coast Guard uses the current year actual costs to project costs for all future years.

Post-employment Military Travel Benefit. U.S. Coast Guard uniformed service members are entitled to travel and transportation allowances for travel performed or to be performed under orders upon separation from the service, including the member's termination, retirement, permanent disability, or pre-retirement death in service. These allowances are provided whether or not the member is on active duty at the time of travel and without regard to the comparative costs of the various modes of transportation.

The U.S. Coast Guard recognizes an expense and a liability for this benefit when a future outflow or other sacrifice of resources is probable and measurable on the basis of events occurring on or before the reporting date. The U.S. Coast Guard treats this entitlement as an Other Retirement Benefit (ORB). Therefore, the liability for this benefit is determined in the same manner as the liability for the MRS by subtracting the sum of the present value of future normal costs from the present value of the future entitlements expected to be paid. The normal cost is computed using the individual entry age normal actuarial cost method.

***Uniformed Division and Special Agent Pension Liability*.** The District of Columbia Police and Fireman's Retirement System (the DC Pension Plan) is a defined benefit plan that covers USSS Uniformed Division and Special Agents. The DC Pension Plan makes benefit payments to retirees and/or their beneficiaries. USSS receives permanent, indefinite appropriations each year to pay the excess of benefit payments over salary deductions. The DC Pension Plan is a pay-as-you-go system funded through annual appropriations. The unfunded accrued liability reported on the accompanying Balance Sheet is actuarially determined by subtracting the present value of future employer/employee contributions, as well as any plan assets, from the present value of future cost of benefits. Current period expense is computed using the aggregate cost method.

For more information on Civilian Pension and OPEB, MRS Liability, Post-employment Military Travel Benefits, and Uniformed Division and Special Agent Pension Liability see Note 16, Federal Employee and Veterans' Benefits.

W. Earmarked Funds

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities, benefits, or purposes, and must be accounted for separately from the Federal Government's general revenues.

Earmarked non-exchange revenue and other financing sources, including appropriations and net cost of operations, are shown separately on the Statements of Changes in Net Position. The portion of cumulative results of operations attributable to earmarked funds is shown separately on both the Statements of Changes in Net Position and the Balance Sheets.

For additional information see Note 22, Earmarked Funds, and Note 5, Investments, Net.

X. Revenue and Financing Sources

Appropriations. The Department receives the majority of funding to support its programs through Congressional appropriations. The Department receives annual, multi-year, and no-year appropriations that may be used, within statutory limits, for operating and capital expenditures. Additional funding is obtained through exchange revenues, non-exchange revenues, and transfers-in.

Appropriations are recognized as financing sources when related expenses are incurred or assets are purchased. Revenue from reimbursable agreements is recognized when the goods or services are provided by the Department. Prices for goods and services sold to the public are based on recovery of full cost or are set at a market price. Reimbursable work between Federal agencies is subject to the *Economy Act (31 United States Code (U.S.C.) 1535)* or other statutes authorizing reimbursement. Prices for goods and services sold to other Federal Government agencies are generally limited to the recovery of direct cost.

Allocation Transfers. The Department is a party to allocation transfers with other Federal agencies as both a transferring (parent) entity and/or a receiving (child) entity. Allocation transfers are legal delegations by one department of its authority to obligate budget authority and outlay funds to another department. A separate fund account (allocation account) is created in the U.S. Treasury as a subset of the parent fund account for tracking and reporting purposes. All allocation transfers of balances are credited to this account, and subsequent obligations and outlays incurred by the child entity are charged to this allocation account as they execute the delegated activity on behalf of the parent entity. Generally, all financial activity related to these allocation transfers (e.g., budget authority, obligations, outlays) is reported in the financial statements of the parent entity, from which the underlying legislative authority, appropriations, and budget apportionments are derived. During FY 2007, the Department, as the parent, allocated funds related to activities for the Biodefense Countermeasures Fund to the U.S. Department of Health and Human Services (HHS). During FY 2008, OMB granted an exemption from reporting this fund as a parent for FY 2008 and future periods. Therefore, balances from these funds will no longer be reported in the DHS financial statements and related footnotes. Based on the exemption granted by OMB, this change does not result in a restatement or reclassification of prior year amounts. DHS receives allocation transfers, as the child, from GSA, the U.S. Department of Transportation, and the Environmental Protection Agency.

Exchange and Non-Exchange Revenue. Exchange revenues are recognized when earned and are derived from transactions where both the government and the other party receive value; i.e., goods have been delivered or services have been rendered. Non-exchange revenues from user fees are recognized as earned in accordance with the *Consolidated Omnibus Budget Reconciliation Act of 1985 (P.L. 99-272)*, as amended. Non-exchange revenues also arise from transfers-in with and without financing sources and donations from the public. Other financing sources, such as donations and transfers of assets without reimbursements, are recognized on the Statements of Changes in Net Position during the period in which the donations and transfers occurred.

Deferred revenue is recorded when the Department receives payment for goods or services which have not been fully rendered. Deferred revenue is reported as a liability on the Balance Sheets until earned. Information and specific examples of deferred revenue include:

- Fees for flood mitigation products and services, such as insurance provided through FEMA's NFIP, are established at rates with the intent of generating sufficient premiums to cover losses and loss adjustment expenses of a historical average loss year and to provide a surplus to compensate the Insurance Underwriting Operations for the loss potential of an unusually severe loss year due to catastrophic flooding. NFIP premium revenues are recognized ratably over the life of the policies. Deferred revenue relates to unearned premiums reserved to provide for the remaining period of insurance coverage.
- USCIS requires advance payments of the fees for adjudication of applications or petitions for immigration and naturalization benefits. A major portion of the revenue received for certain applicant types is deferred and not considered earned until the application is adjudicated.

Imputed Financing Sources. In certain instances, operating costs of DHS are paid out of funds appropriated to other Federal agencies. For example, OPM, by law, pays certain costs of retirement programs, and certain legal judgments against DHS are paid from a Judgment Fund maintained by the Treasury. When costs that are identifiable to DHS and directly attributable to DHS operations are paid by other agencies, DHS recognizes these amounts as operating expenses. DHS also recognizes an imputed financing source on the Statements of Changes in Net Position to indicate the funding of DHS operations by other Federal agencies.

Custodial Revenue. Non-entity revenue and refunds are reported on the Statements of Custodial Activity using a modified cash basis. Non-entity revenue reported on the Department's Statement of Custodial Activity include duties, excise taxes, and various non-exchange fees collected by CBP and USCIS that are subsequently remitted to the Treasury General Fund or to other Federal agencies. Duties, user fees, fines and penalties are assessed pursuant to the provisions of Title 19 United States Code (U.S.C.); nonimmigrant petition fees under Title 8 U.S.C., and excise taxes under Title 26 U.S.C. CBP also enforces over 400 laws and regulations some of which require the collection of fees or the imposition of fines and penalties pursuant to other Titles within the U.S.C. or Code of Federal Regulations (C.F.R.).

CBP assesses duties, taxes, and fees on goods and merchandise brought into the United States from foreign countries. The custodial revenue is recorded at the time of collection. These revenue collections primarily result from current fiscal year activities. Generally, CBP records an equal and offsetting liability due to the Treasury General Fund for amounts recognized as non-entity tax and trade receivable and custodial revenue. Non-entity tax and trade accounts receivables are recognized when CBP is entitled to collect duties, user fees, fines and penalties, refunds and drawback overpayments, and interest associated with import/export activity on behalf of the Federal Government that have been established as a specifically identifiable, legally enforceable claim and remain uncollected as of year-end. CBP accrues an estimate of duties, taxes, and fees related to commerce released prior to year-end where receipt of payment is anticipated subsequent to year-end. Fees collected by USCIS for nonimmigrant petitions must be submitted with the petition. The portions of the fees that are subsequently remitted to other Federal agencies are recorded as custodial revenue at the time of collection.

Non-entity receivables are presented net of amounts deemed uncollectible. CBP tracks and enforces payment of estimated duties, taxes, and fees receivable by establishing a liquidated damage case that generally results in fines and penalties receivable. A fine or penalty, including interest on past due balances, is established when a violation of import/export law is discovered. An allowance for doubtful collections is established for substantially all accrued fines and penalties and related interest. The amount is based on past experience in resolving disputed assessments, the debtor's payment record and willingness to pay, the probable recovery of amounts from secondary sources, such as sureties and an analysis of aged receivable activity. CBP regulations allow importers to dispute the assessment of duties, taxes, and fees. Receivables related to disputed assessments are not recorded until the protest period expires or a protest decision is rendered in CBP's favor.

Refunds and drawback of duties, taxes, and fees are recognized when payment is made. A permanent, indefinite appropriation is used to fund the disbursement of refunds and drawbacks. Disbursements are recorded as a decrease in the amount Transferred to Federal Entities as reported on the Statement of Custodial Activity. An accrual adjustment is recorded on the Statements of Custodial Activity to adjust cash collections and refund disbursements with the net increase or decrease of accrued non-entity accounts receivables, net of uncollectible amounts, and refunds payable at year-end.

For additional information see Note 7, Taxes, Duties, and Trade Receivables, Net, and Note 32, Custodial Revenues.

Y. Taxes

The Department, as a Federal agency, is not subject to Federal, State, or local income taxes and accordingly, no provision for income taxes has been recorded in the accompanying financial statements.

Z. Restatements

In FY 2008, the Department restated certain FY 2007 balances. For additional information see Note 33, Restatements.

2. Non-Entity Assets

Non-entity assets at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Intragovernmental:		
Fund Balance with Treasury	$966	$1,130
Due From Treasury	151	176
Total Intragovernmental	1,117	1,306
Cash and Other Monetary Assets	15	48
Accounts Receivable, Net	21	17
Taxes, Duties, and Trade Receivables, Net	2,078	1,937
Total Public	2,114	2,002
Total Non-Entity Assets	3,231	3,308
Total Entity Assets	84,664	75,816
Total Assets	**$87,895**	**$79,124**

Non-entity Fund Balance with Treasury consists of special and deposit funds, permanent and indefinite appropriations, and miscellaneous receipts that are available to pay non-entity liabilities. Non-entity assets (also discussed in Notes 3 and 7) are offset by non-entity accrued liabilities at September 30, 2008 and 2007 (see Note 18). Non-entity receivables due from Treasury represent an estimate of duty, tax, and/or fee refunds and drawbacks that will be reimbursed by a permanent and indefinite appropriation account and will be used to pay estimated refunds and drawbacks payable. Duties and taxes receivable from the public represent amounts due from importers for goods and merchandise imported to the United States.

3. Fund Balance with Treasury

A. Fund Balance with Treasury

Fund Balance with Treasury at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Appropriated Funds	$57,063	50,770
Trust Funds	54	60
Revolving, Public Enterprise, and Working Capital Funds	896	963
Special Funds	4,555	3,563
Deposit Funds	589	829
Total Fund Balance with Treasury	**$63,157**	**$56,185**

Appropriated funds consist of amounts appropriated annually by Congress to fund the operations of the Department. Appropriated funds include clearing funds totaling $(42) million and $105 million at September 30, 2008 and 2007, respectively, which represent reconciling differences with Treasury balances.

Trust funds include both receipt accounts and expenditure accounts that are designated by law as a trust fund. Trust fund receipts are used for specific purposes, generally to offset the cost of expanding border and port enforcement activities and oil spill related claims and activities.

Revolving funds are used for continuing cycles of business-like activity, in which the fund charges for the sale of products or services and uses the proceeds to finance its spending, usually without requirement for annual appropriations. A public enterprise revolving fund is an account that is authorized by law to be credited with offsetting collections from the public and those monies are used to finance operations. The Working Capital Fund is a fee-for-service fund established to support operations of Department Components. Also included are the financing funds for credit reform and the National Flood Insurance Fund.

Special funds include funds designated for specific purposes including the disbursement of non-entity monies received in connection with antidumping and countervailing duty orders due to qualifying Injured Domestic Industries (IDI). The Department also has special funds for immigration and naturalization user fees and CBP user fees, as well as inspection fees, flood map modernization subsidy, and off-set and refund transfers. For additional information, see Note 22, Earmarked Funds.

Deposit funds represent amounts received as an advance that are not accompanied by an order and include non-entity collections that do not belong to the Federal Government.

B. Status of Fund Balance with Treasury

The status of Fund Balance with Treasury at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Budgetary Status		
Unobligated Balances:		
Available	$7,319	$9,266
Unavailable	14,004	8,596
Obligated Balance Not Yet Disbursed	44,788	41,053
Total Budgetary Status	66,111	58,915
Reconciling Adjustments:		
Receipt, Clearing, and Deposit Funds	655	940
Borrowing Authority	(3,415)	(3,465)
Investments	(3,063)	(2,767)
Receivable Transfers and Imprest Fund	(260)	(130)
Receipts unavailable for obligation	1,744	1,566
Authority Temporarily Precluded from Obligation	39	25
SFRBTF	1,346	1,101
Total Fund Balance with Treasury	**$63,157**	**$56,185**

Portions of the Unobligated Balances Available, Unavailable and Obligated Balance Not Yet Disbursed contain CBP's user fees of $768 million and $730 million at September 30, 2008 and 2007, respectively, which is restricted by law in its use to offset costs incurred by CBP. Further, the Unobligated Balances Available include appropriations received in the Disaster Relief Fund. As of September 30, 2008 and 2007, this fund has an unobligated balance available of $937 million and $4.4 billion, respectively.

Portions of the Unobligated Balance Unavailable include amounts appropriated in prior fiscal years that are not available to fund new obligations. However, it can be used for upward and downward adjustments for existing obligations in future years. The Obligated Balance Not Yet Disbursed represents amounts designated for payment of goods and services ordered but not received or goods and services received but for which payment has not yet been made.

The fluctuations in the Budgetary Status, including Unobligated Balances and Obligated Balance Not Yet Disbursed, primarily relate to the receipt of supplemental funding received by FEMA for hurricane related flooding, the change in the reporting requirement for the Biodefense Countermeasure Fund as described in Note 35, and obligations not yet disbursed for Secure Border Initiative fencing.

Since the following line items do not post to budgetary status accounts, the following adjustments are required to reconcile the budgetary status to non-budgetary Fund Balance with Treasury as reported in the accompanying Balance Sheets:

- Receipt, clearing, and deposit funds represent amounts on deposit with Treasury that have no budget status at September 30, 2008 and 2007.
- Borrowing authority is in budgetary status for use by FEMA for disaster relief purposes and Community disaster loans.
- Budgetary resources have investments included; however, the money has been moved from the Fund Balance with Treasury asset account to Investments.
- Receivable transfers of currently invested balances increase the budget authority at the time the transfer is realized; however, obligations may be incurred before the actual transfer of funds.
- Imprest funds represent monies moved from Fund Balance with Treasury to Cash and Other Monetary Assets with no change in the budgetary status.
- For receipts unavailable for obligations, authorizing legislation may specify that obligations are not available until a specified time in the future or until specific legal requirements are met.
- Sport Fish Restoration Boating Trust Fund (SFRBTF) is a Treasury-managed fund. This fund receives revenues transferred from custodial activities of the Treasury which are deposited in a Treasury account (see Note 22).

4. Cash and Other Monetary Assets

Cash and Other Monetary Assets at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Cash	$63	$282
Seized Monetary Instruments	4	39
Total Cash and Other Monetary Assets	**$67**	**$321**

DHS cash includes cash held by others, including the net balance maintained by insurance companies for flood insurance premiums received from policyholders, less amounts paid for insured losses; imprest funds; and undeposited cash, which represent fees collected but not yet deposited. In FY 2007, an announced increase in immigration application fees and a demand for preference visa categories, which became available under the Department of State’s July 2007 Visa Bulletin, combined to create a large increase in immigration applications, resulting in an increase in immigration application fees collected but not yet deposited. Seized Monetary Instruments are held until disposition. The decrease in seized monetary instruments relates to gold coins no longer reported by the USSS. As of September 30, 2008 and 2007, restricted non-entity cash and other monetary assets is $15 million and $48 million, respectively.

5. Investments, Net

Investments at September 30, 2008, consisted of the following (in millions) (unaudited):

Type of Investment:	Amortization Method	Cost	Amortized (Premium) Discount	Interest Receivable	Investments, Net (Unaudited)	Market Value Disclosure
Intragovernmental Securities:						
Oil Spill Liability Trust Fund	Effective interest method	$1,124	$31	$ -	$1,155	N/A
Sport Fish Restoration Boating Trust Fund	Effective interest method	1,948	(2)	-	1,946	N/A
Total Non-Marketable		3,072	29	-	3,101	N/A
Non-Marketable, Market-Based	Straight line method	2	-	2 -	2	
Total Investments, Net		**$3,074**	**$29**	**$ -**	**$3,103**	**N/A**

Investments at September 30, 2007, consisted of the following (in millions) (unaudited and restated):

Type of Investment:	Amortization Method	Cost	Amortized (Premium) Discount	Interest Receivable	Investments, Net (Unaudited)	Market Value Disclosure
Intragovernmental Securities:						
Oil Spill Liability Trust Fund	Effective interest method	$925	$(7)	$ -	$918	N/A
Sport Fish Restoration Boating Trust Fund	Effective interest method	1,841	5	-	1,846	N/A
Total Non-Marketable		2,766	(2)	-	2,764	N/A
Non-Marketable, Market-Based	Straight line method	14	-	-	14	14
Total Investments, Net		**$2,780**	**$(2)**	**$ -**	**$2,778**	**N/A**

The Federal Government does not set aside assets to pay future benefits or other expenditures associated with earmarked funds (Oil Spill Liability Trust Fund, Sport Fish Restoration Boating Trust Fund, and General Gift Fund) for the U.S. Coast Guard. The cash receipts collected from the public for an earmarked fund are deposited in the Treasury, which uses the cash for general Federal Government purposes. Treasury securities are issued to the U.S. Coast Guard as evidence of its receipts. Treasury securities associated with earmarked funds are an asset to the U.S. Coast Guard and a liability to the Treasury. Because Treasury and DHS are both parts of the Federal

Government, these assets and liabilities offset each other from the standpoint of the Federal Government as a whole. For this reason, these funds do not represent an asset or a liability in the U.S. Government-wide financial statements.

Treasury securities provide the U.S. Coast Guard with authority to draw upon the Treasury to make future benefit payments or other expenditures

6. Accounts Receivable, Net

Accounts Receivable, net, at September 30, consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Intragovernmental	**$310**	**$279**
With the Public:		
Accounts Receivable	737	1,229
Allowance for Doubtful Accounts	(249)	(469)
	488	**760**
Accounts Receivable, Net	**$798**	**$1,039**

Intragovernmental accounts receivable results from reimbursable work performed by the Department. Accounts receivable with the public consist of amounts due for reimbursable services and user fees. The decreases in accounts receivable with the public and allowance for doubtful accounts are primarily caused by FEMA suspension of recoupment efforts for payments made to disaster applicants affected by Hurricanes Katrina and Rita.

7. Taxes, Duties, and Trade Receivables, Net

Taxes, Duties, and Trade Receivables consisted of the following (in millions):

As of September 30, 2008 (Unaudited):

Receivables Category	Gross Receivables	Allowance	Total Net Receivables
Duties	$1,842	$(128)	$1,714
Excise Taxes	99	(6)	93
User Fees	144	(4)	140
Fines/Penalties	942	(887)	55
Anti-Dumping and Countervailing Duties	364	(288)	76
Total Tax, Duties, and Trade Receivables, Net	**$3,391**	**$(1,313)**	**$2,078**

As of September 30, 2007 (Unaudited)(Restated):

Receivables Category	Gross Receivables	Allowance	Total Net Receivables
Duties	$1,649	$(116)	$1,533
Excise Taxes	127	(6)	121
User Fees	132	(5)	127
Fines/Penalties	1,260	(1,185)	75
Anti-Dumping and Countervailing Duties	357	(277)	80
Refunds and Drawbacks	2	(1)	1
Total Tax, Duties, and Trade Receivables, Net	**$3,527**	**$(1,590)**	**$1,937**

When a violation of import/export law is discovered, a fine or penalty is established. CBP assesses a liquidated damage or penalty for these cases to the maximum extent of the law. After receiving the notice of assessment, the importer or surety has a period of time to either file a petition requesting a review of the assessment or pay the assessed amount. Once a petition is received, CBP investigates the circumstances as required by its mitigation guidelines and directives. Until this process has been completed, CBP records an allowance on fines and penalties of approximately 94 percent (94 percent at September 30, 2007) of the total assessment based on historical experience of fines and penalties mitigation and collection. Duties and taxes receivables are non-entity assets for which there is an offsetting liability due to the Treasury General Fund.

8. Direct Loans, Net

DHS's loan program consists of two types of direct loans, both administered by FEMA: (1) State Share Loans: FEMA may lend or advance to a state or an eligible applicant the portion of assistance for which the applicant is responsible under cost-sharing provisions of the Stafford Act. For 1992 and beyond, the State Share Loans are obligated from the Disaster Assistance Direct Loan Financing Account; and (2) Community Disaster Loans (CDLs): Loans may be authorized to local governments that have suffered a substantial loss of tax and other revenues as a result of a major disaster, and have demonstrated a need for financial assistance in order to perform their municipal operating functions. The loans are made at the current Treasury rate for a term of five years and cannot exceed 25 percent of the annual operating budget of the local government for the fiscal year in which the major disaster occurred, with the exception of Hurricanes Katrina/Rita Special CDL. The rates for Katrina/Rita Special CDL are less than the Treasury rate and cannot exceed 50 percent of the annual operating budget of the local government for the fiscal year in which the major disaster occurred. In addition, in accordance with recent Stafford Act amendments (P.L. 109-88), CDLs may exceed $5 million and shall not be cancelled. However, P.L. 110-28 amended the *Community Disaster Loan Act of 2005* (P.L. 109-88) by striking "Provided further, that notwithstanding section 471(c)(1) of the *Stafford Act*, such loans may not be cancelled." This resulted in total modification costs of $327 million (unaudited) for the 2006 Cohort. Of this amount, $207 million (unaudited) was transferred to the financing account to repay funds borrowed from Treasury. The balance remains in the Programming account to cover costs of undisbursed loans for the 2006 Cohort.

Loans totaling $161 million and $162 million have been disbursed to eligible borrowers as of September 30, 2008 and 2007, respectively. Disbursements are tracked by cohort as determined by the date of obligation rather than disbursement.

A. Summary of Direct Loans to Non-Federal Borrowers at September 30 (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
	Loans Receivable, Net	Loans Receivable, Net
Community Disaster Loans	$21	**$ -**

An analysis of loans receivable and the nature and amounts of the subsidy and administrative costs associated with the direct loans is provided in the following sections.

B. Direct Loans Obligated After FY 1991 (in millions):

At September 30, 2008 (Unaudited):	Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
Community Disaster Loans	**$952**	**$56**	**$(987)**	**$21**

At September 30, 2007 (Unaudited)(Restated):	Loans Receivable, Gross	Interest Receivable	Allowance for Subsidy Cost (Present Value)	Value of Assets Related to Direct Loans
Community Disaster Loans	**$792**	**$30**	**$(822)**	**$ -**

C. Total Amount of Direct Loans Disbursed, Post-1991 (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Community Disaster Loans	**$161**	**$162**

D. Subsidy Expense for Direct Loans by Program and Component (in millions):

Subsidy Expense for New Direct Loans Disbursed as of September 30 (in millions):

Community Disaster Loans	Interest Differential	Defaults and Other	Total
2008 (Unaudited)	$37	$124	$161
2007 (Unaudited) (Restated)	$28	$93	$121

Modifications and Reestimates as of September 30 (in millions):

Community Disaster Loans	Interest Rate Reestimates
2008 (Unaudited)	$ -
2007 (Unaudited) (Restated)	$207

For the Community Disaster Loan Program the technical re-estimates for FY 2008 and FY 2007 were less than $1 million.

Total Direct Loan Subsidy Expense

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Community Disaster Loans	**$161**	**$329**

E. Direct Loan Subsidy Rates at September 30 (in millions):

The direct loan subsidy rates, by program, are as follows:

	2008 (Unaudited)		2007 (Unaudited)	
	Community Disaster Loans	State Share Loans	Community Disaster Loans	State Share Loans
Interest Subsidy Cost	5.01%	1.38%	4.9%	0.82%
Default Costs	- %	- %	- %	- %
Other	88.28%	0.35%	88.5%	0.36%

F. Schedule for Reconciling Subsidy Cost Allowance Balances at September 30 (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Beginning Balance of the Subsidy cost allowance	$822	$479
Add subsidy expense for direct loans disbursed during the reporting years by component:		
(a) Interest rate differential costs	37	28
(b) Other subsidy costs	124	93
Adjustments:		
(a) Loans written off	-	(1)
(b) Subsidy allowance amortization	4	16

(c) Other	-	207
Ending balance of the subsidy cost allowance before reestimates	987	822
Add subsidy reestimate by component		
(a) Technical/default reestimate	-	-
Ending balance of the subsidy cost allowance	**$987**	**$822**

As of September 30, 2008, there were no loans written off. As of September 30, 2007, the amount of loans written off was $1 million.

G. Administrative Expenses at September 30 (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Community Disaster Loans	**$0.5**	**$0.5**

9. Inventory and Related Property, Net

Inventory and Related Property, net at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Operating Materials and Supplies (OM&S)		
Items Held for Use	$323	$302
Items Held for Future Use	32	30
Excess, Obsolete and Unserviceable Items	132	149
Less: Allowance for Losses	(123)	(149)
Total OM&S, Net	**364**	**332**
Inventory		
Inventory Purchased for Resale	89	61
Less: Allowance for Losses	(5)	(4)
Total Inventory, Net	**84**	**57**
Stockpile Materials Held in Reserve	**70**	**243**
Total Inventory and Related Property, Net	**$518**	**$632**

The significant decrease in stockpile materials held in reserve was related to FEMA's issuance of disaster related materials for Hurricanes Gustav and Ike in FY 2008.

10. Seized and Forfeited Property

Prohibited seized property item counts as of September 30 and activity for FY 2008 and 2007 are as follows:

Seizure Activity						
Fiscal Year Ended September 30, 2008 (Unaudited)						
Seized Property Category:	Beginning Balance	New Seizures	Remissions	New Forfeitures	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	3,254	691,151	-	(694,570)	1,202	1,037
Cocaine	186	19,924	-	(19,876)	(19)	215
Heroin	20	5,866	-	(5,878)	-	8
Ecstasy	33	1,114	-	(1,145)	31	33
Steroids	136	393	(10)	(378)	4	145
Firearms and Explosives (in number of items)	1,130	1,444	(870)	(742)	(89)	873
Counterfeit Currency (US/Foreign, in number of items)	3,998,370	1,375,522	-	-	(1,697,546)	3,676,346
Pornography (in number of items)	76	96	(5)	(87)	(37)	43

Forfeiture Activity						
Fiscal Year Ended September 30, 2008 (Unaudited)						
Forfeited Property Category:	Beginning Balance	New Forfeitures	Transfers	Destroyed	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	172,395	694,570	(1,943)	(508,918)	(239,504)	116,600
Cocaine	21,564	19,876	(281)	(20,803)	15,018	35,374
Heroin	6,592	5,878	(11)	(1,790)	(3,603)	7,066
Ecstasy	1,867	1,145	(100)	(1,231)	(106)	1,575
Steroids	13	378	-	(355)	6	42
Firearms and Explosives (in number of items)	348	742	(732)	(8)	58	408
Pornography (in number of items)	29	87	-	(112)	23	27

Seizure Activity						
Fiscal Year Ended September 30, 2007 (Unaudited) (Restated)						
Seized Property Category:	Beginning Balance	New Seizures	Remissions	New Forfeitures	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	737	774,841	-	(772,729)	405	3,254
Cocaine	353	22,985	-	(23,075)	(77)	186
Heroin	20	5,459	-	(5,463)	4	20
Ecstasy	-	1,426	-	(1,393)	-	33
Steroids	-	514	(65)	(305)	(8)	136
Firearms and Explosives (in number of items)	864	1,970	(886)	(675)	(143)	1,130
Counterfeit Currency (US/Foreign, in number of items)	4,227,431	1,325,661	-	-	(1,554,722)	3,998,370
Pornography (in number of items)	101	173	(3)	(140)	(55)	76

Forfeiture Activity						
Fiscal Year Ended September 30, 2007 (Unaudited) (Restated)						
Forfeited Property Category:	Beginning Balance	New Forfeitures	Transfers	Destroyed	Adjustments	Ending Balance
Illegal Drugs (in kilograms):						
Cannabis (marijuana)	97,304	772,729	(234,858)	(459,151)	(3,629)	172,395
Cocaine	19,584	23,075	(156)	(20,545)	(394)	21,564
Heroin	2,221	5,463	(4)	(1,045)	(43)	6,592
Ecstasy	-	1,393	(9)	(1,060)	1,543	1,867
Steroids	-	305	-	(314)	22	13
Firearms and Explosives (in number of items)	253	675	(607)	(2)	29	348
Pornography (in number of items)	32	140	(1)	(195)	53	29

This schedule is presented for material prohibited (non-valued) seized and forfeited property only. These items are retained and ultimately destroyed by CBP and USSS and are not transferred to the U.S. Departments of Treasury or Justice Asset Forfeiture Funds or other Federal agencies. The ending balance for firearms includes only those seized items that can actually be used as firearms. Illegal drugs are presented in kilograms and a portion of the weight includes packaging, which often cannot be reasonably separated from the weight of the drugs since the packaging must be maintained for evidentiary purposes. The adjustments columns relate to prohibited property adjustments made due to items incorrectly tagged or marked as to seized or forfeited. For seizure activity the adjustments also include destroyed items.

The U.S. Coast Guard also seizes and takes temporary possession of small boats, equipment, contraband, and other illegal drugs. The U.S. Coast Guard usually disposes of these properties within three days by transfer to CBP (who transfers non-prohibited seized property to the Treasury Forfeiture Fund), the Drug Enforcement Administration, foreign governments, or by destroying it. Seized property in U.S. Coast Guard possession at year-end is not considered material and therefore is not itemized and is not reported in the financial statements of the Department.

CBP will take into custody, without risk or expense, merchandise termed "general order property," which for various reasons cannot legally enter into the commerce of the United States. CBP's sole responsibility with general order property is to ensure the property does not enter the Nation's commerce. If general order property remains in CBP custody for a prescribed period of time, without payment of all estimated duties, storage, and other charges, the property is considered unclaimed and abandoned and may be sold by CBP at public auction, retained by CBP for its official use, or at CBP's discretion, transferred to any other Federal, State, or local agency, destroyed, or disposed of otherwise. Auction sales revenue in excess of charges associated with the sale or storage of the item is remitted to the Treasury General Fund. In some cases, CBP incurs charges prior to the sale and funds these costs from entity appropriations. Regulations permit CBP to offset these costs of sale before returning excess amounts to Treasury.

11. General Property, Plant, and Equipment, Net

General Property, Plant, and Equipment (PP&E) consisted of the following (in millions):

As of September 30, 2008 (Unaudited):	Service Life	Gross Cost	Accumulated Depreciation/ Amortization	Total Net Book Value
Land and Land Rights	N/A	$131	N/A	$131
Improvements to Land	2-50 yrs	415	86	329
Construction in Progress	N/A	5,010	N/A	5,010
Buildings, Other Structures and Facilities	2-50 yrs	4,613	2,202	2,411
Equipment:				
Automated Data Processing Equipment	5 yrs	373	243	130
Aircraft	12-35 yrs	2,836	1,678	1,158

Vessels	5-57 yrs	5,127	2,471	2,656
Vehicles	3-8 yrs	530	403	127
Other Equipment	2-30 yrs	4,432	2,940	1,492
Assets Under Capital Lease	2-40 yrs	78	28	50
Leasehold Improvements	2-50 yrs	465	156	309
Internal Use Software	2-5 yrs	1,099	899	200
Internal Use Software- in Development	N/A	498	N/A	498
Total General Property, Plant, and Equipment, Net		**$25,607**	**$11,106**	**$14,501**

As of September 30, 2007 (Unaudited)(Restated):	Service Life	Gross Cost	Accumulated Depreciation/ Amortization	Total Net Book Value
Land and Land Rights	N/A	$90	N/A	$90
Improvements to Land	3-50 yrs	114	49	65
Construction in Progress	N/A	4,468	N/A	4,468
Buildings, Other Structures and Facilities	2-50 yrs	4,148	1,993	2,155
Equipment:				
Automated Data Processing Equipment	3-5 yrs	317	191	126
Aircraft	10-35 yrs	2,722	1,558	1,164
Vessels	5-65 yrs	4,317	2,365	1,952
Vehicles	3-8 yrs	573	448	125
Other Equipment	2-30 yrs	4,031	2,456	1,575
Assets Under Capital Lease	2-20 yrs	79	26	53
Leasehold Improvements	3-50 yrs	364	104	260
Internal Use Software	2-10 yrs	963	751	212
Internal Use Software- in Development	N/A	357	N/A	357
Total General Property, Plant, and Equipment, Net		**$22,543**	**9,941**	**$12,602**

12. Stewardship Property, Plant, and Equipment

The following table summarizes physical unit information related to heritage assets for the fiscal years ended September 30 (in number of units).

	2008 (Unaudited)	2007 (Unaudited)
U.S. Coast Guard	20,463	20,549
CBP	4	4
FEMA	1	1
Total	**20,468**	**20,554**

DHS's Stewardship PP&E primarily consists of U.S. Coast Guard's heritage assets, which are unique due to historical, cultural, artistic, or architectural significance. These assets are used to preserve and to provide education on U.S. Coast Guard history and tradition. Heritage assets are generally expected to be preserved indefinitely. Multi-use heritage assets have more than one purpose, such as operational or historical and are included with General PP&E.

The U.S. Coast Guard possesses artifacts that can be divided into six general areas: ship's equipment, lighthouse and other aids-to-navigation/communication items, personal use items, ordnance, artwork, and display models. The U.S. Coast Guard also has non-collection type Heritage Assets, such as sunken vessels and aircraft, under the property clause of the U.S. Constitution, Articles 95 and 96 of the International Law of the Sea Convention, and the sovereign immunity provisions of Admiralty law. Despite the passage of time or the physical condition of these assets, they remain government-owned until the Congress of the United States formally declares them abandoned. The U.S. Coast Guard desires to retain custody of these assets to safeguard the remains of crew members lost at sea, to prevent the unauthorized handling of explosives or ordnance which may be aboard, and to preserve culturally valuable relics of the U.S. Coast Guard.

The U.S. Coast Guard does not acquire or retain heritage buildings and structures without an operational use. Most real property, even if designated as historical, is acquired for operational use and is transferred to other government agencies or public entities when no longer required for operations. Of the U.S. Coast Guard buildings and structures designated as heritage, including memorials, recreational areas, and other historical areas, over two-thirds are multi-use heritage. The remaining assets include historical lighthouses, which are no longer in use and awaiting disposal, and historical vessels and aircraft artifacts preserved and recorded for memorial purposes and historical significance.

CBP also has four multi-use heritage assets located in Puerto Rico, and FEMA has one multi-use heritage asset that is used by the U.S. Fire Administration for training in Emmitsburg, Maryland. All multi-use heritage assets are reflected on the Balance Sheet as general PP&E and depreciated over their useful life. Heritage asset addition and withdrawal information and deferred maintenance for heritage assets and general PP&E are presented in the required supplementary information.

13. Other Assets

Other Assets at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Intragovernmental:		
Advances and Prepayments	$2,852	$2,887
Due from Treasury	151	176
Total Intragovernmental	**3,003**	**3,063**
Public:		
Advances and Prepayments	649	567
Total Public	**649**	**567**
Total Other Assets	**$3,652**	**$3,630**

Intragovernmental Advances and Prepayments primarily consist of FEMA's Disaster Relief Fund disaster assistance advances to other Federal agencies (principally the U.S. Department of Transportation) tasked with restoration efforts of the New York City region transportation system.

The Department provides advance funds to public grant recipients to incur expenses related to the approved grant. Advances are made within the amount of the total grant obligation.

14. Liabilities Not Covered by Budgetary Resources

Liabilities Not Covered by Budgetary Resources at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Intragovernmental:		
Debt (Note 15)	$17,110	$17,786
Accrued FECA Liability (Note 18)	361	355
Other	57	51
Total Intragovernmental	17,528	18,192
Public:		
Federal Employee and Veterans' Benefits:		
Actuarial FECA Liability (Note 16)	1,796	1,683
Military Service and Other Retirement Benefits (Note 16)	34,434	33,227
Environmental and Disposal Liabilities (Note 17)	254	254
Other:		
Accrued Payroll and Benefits (Note 18)	972	874
Insurance Liabilities (Note 20)	5,531	1,508
Contingent Legal Liabilities (Note 21)	280	179
Capital Lease Liability (Note 19)	89	107
Total Public	43,356	37,832
Total Liabilities Not Covered by Budgetary Resources	60,884	56,024
Liabilities Covered by Budgetary Resources or Non-Entity Assets	13,531	13,173
Total Liabilities	**$74,415**	**$69,197**

The Department anticipates that the liabilities listed above will be funded from future budgetary resources when required.

15. Debt

Debt at September 30 consisted of the following (in millions):

Fiscal year ended September 30, 2008	Beginning Balance	Net Borrowing/ Repayment	Ending Balance (Unaudited)
Debt to the Treasury General Fund:			
Debt for the NFIP	$17,902	$(183)	$17,719
Debt for Credit Reform	251	(251)	-
Total Debt to the Treasury General Fund	$18,153	$(434)	$17,719
Total Debt	**$18,153**	**$(434)**	**$17,719**

Fiscal year ended September 30, 2007	Beginning Balance	Net Borrowing/ Repayment	Ending Balance (Unaudited)
Debt to the Treasury General Fund:			
Debt for the NFIP	$17,239	$663	$17,902
Debt for Credit Reform	207	44	251
Total Debt to the Treasury General Fund	$17,446	$707	$18,153
Total Debt	**$17,446**	**$707**	**$18,153**

DHS's intragovernmental debt is owed to Treasury's Bureau of Public Debt (BPD) and consists of borrowings to finance claims under NFIP and borrowings to finance FEMA's credit reform programs (Disaster Assistance Direct Loan Program).

NFIP loans are for a three-year term. Interest rates are obtained from the BPD and range by cohort year from 1.88 percent to 4.88 percent as of September 30, 2008 and from 3.38 percent to 4.88 percent as of September 30, 2007. Simple interest is calculated monthly – offset by an interest rebate, if applicable. The interest rebate is calculated at a rate equal to the weighted average of the interest rates of outstanding loans for the month multiplied by the "positive" daily account fund balance for the month. Interest is paid semi-annually on October 1 and April 1. Interest is accrued based on the loan balances reported by BPD. Principal repayments are required only at maturity, but are permitted any time during the term of the loan. Flood premiums from policy holders and map collection fees are intended to repay loan principal and interest payments due to Treasury; however, due to the size of the debt incurred for damages sustained for Hurricanes Katrina and Rita, premiums received are only sufficient to cover the interest payments. Congress will need to enact legislation to provide funding to repay the Treasury Department, or to forgive the debt.

Under Credit Reform, the unsubsidized portion of direct loans is borrowed from the Treasury. The repayment terms of FEMA's borrowing from Treasury are based on the life of each cohort of direct loans. Proceeds from collections of principal and interest from the borrowers are used to repay the Treasury. In addition, an annual reestimate is performed to determine any change from the original subsidy rate. If an upward reestimate is determined to be necessary, these funds are available through permanent indefinite authority which is to be approved by OMB. Once these funds are appropriated, the original borrowings are repaid to Treasury. The weighted average interest rates for FY 2008 and FY 2007 were 5.09 percent and 4.87 percent, respectively.

16. Federal Employee and Veterans' Benefits

Accrued liability for military service and other retirement and employment benefits at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
U.S. Coast Guard Military Retirement and Healthcare Benefits	$30,661	$29,494
U.S. Coast Guard Post-Employment Military Travel Benefits	82	133
USSS DC Pension Plan Benefits	3,686	3,595
Actuarial FECA Liability	1,796	1,683
Other	5	5
Total Federal Employee and Veterans' Benefits	**$36,230**	**$34,910**

A. U.S. Coast Guard Military Retirement and Healthcare Benefits

The components of the MRS expense for the years ended September 30 consisted of the following (in millions):

Defined Benefit Plan:	2008 (Unaudited)	2007 (Unaudited) (Restated)
Normal cost	$682	$653
Interest on the liability	1,510	1,417
Actuarial losses/(gains)	(501)	120
Actuarial Assumption Change	-	721
Plan Amendments	-	136
Total Defined Benefit Plan Expense	**$1,691**	**$3,047**
Post-retirement Healthcare:		
Normal cost	$173	$151
Interest on the liability	275	287
Other Actuarial (gains)/losses	185	(281)
Total Post-retirement Healthcare Expense	**633**	**157**
Total MRS Expense	**$2,324**	**$3,204**

The U.S. Coast Guard's military service members (both active duty and reservists) participate in the MRS. The U.S. Coast Guard receives an annual "Retired Pay" appropriation to fund MRS benefits. The retirement system allows voluntary retirement for active members upon credit of at least 20 years of active service at any age. Reserve members may retire after 20 years of creditable service with benefits beginning at age 60. The U.S. Coast Guard's MRS includes the U.S. Coast Guard Military Health Services System (Health Services Plan). The Health Services Plan is a post-retirement medical benefit plan, which covers all active duty and reserve members of the U.S. Coast Guard.

A portion of the accrued MRS liability is for the health care of non-Medicare eligible retirees and survivors. Effective October 1, 2002, the U.S. Coast Guard transferred its liability for the health care of Medicare eligible retirees/survivors to the DOD MERHCF, which was established in order to finance the health care benefits for the Medicare-eligible beneficiaries of all DOD and non-DOD uniformed services. DOD is the administrative entity for the MERHCF and in accordance with SFFAS No. 5, is required to recognize the liability on the MERHCF's financial statements. The U.S. Coast Guard makes annual payments to the MERHCF for current active duty members and current reservists. Benefits for U.S. Coast Guard members who retired prior to the establishment of the MERHCF are provided by payments from the Treasury to the MERHCF. The future cost and liability of the MERHCF is determined using claim factors and claims cost data developed by the DOD, adjusted for U.S. Coast Guard retiree and actual claims experience. The U.S. Coast Guard uses the current year actual costs to project costs for all future years.

The unfunded accrued liability, presented as a component of the liability for military service and other retirement benefits in the accompanying Balance Sheet, represents both retired pay and health care benefits for non-Medicare eligible retirees/survivors. Valuation of the plan's liability is based on the actuarial present value of accumulated plan benefits derived from the future payments that are attributable, under the retirement plan's provisions, to a participant's credited service as of the valuation date. Credited service is the years of service from active duty base date (or constructive date in the case of active duty reservists) to date of retirement measured in years and completed months. The present value of future benefits is then converted to an unfunded accrued liability by subtracting the present value of future employer/employee normal contributions. U.S. Coast Guard plan participants may retire after 20 years of active service at any age with annual benefits equal to 2.5 percent of retired base pay for each year of credited service. Personnel who became members after August 1, 1986, may elect to receive a $30,000 lump sum bonus after 15 years of service and reduced benefits prior to age 62. Annual disability is equal to the retired pay base multiplied by the larger of: 1) 2.5 percent times years of service; or 2) the percent of member disability. The benefit cannot be more than 75 percent of retired pay base. If a U.S. Coast Guard member is disabled, the member is entitled to disability benefits, assuming the disability is at least 30 percent (under a standard schedule of rating disabilities by Veterans Affairs) and either: 1) the member has one month and one day of service; 2) the disability results from active duty; or 3) the disability occurred in the line of duty during a time of war or national emergency or certain other time periods.

The significant actuarial assumptions used to compute the MRS accrued liability are:

- life expectancy and expected future service are based upon the DOD decrement (mortality, disability, withdrawal, and retirement) tables, as adjusted to reflect actual U.S. Coast Guard experience;
- cost of living increases are 3.75 percent annually; and
- annual rate of investment return is 6.0 percent.

B. District of Columbia Police and Fireman's Retirement System for U.S. Secret Service Employees

Special agents and other USSS personnel in certain job series hired as a civilian before January 1, 1984, are eligible to transfer to the District of Columbia Police and Fireman's Retirement System (DC Pension Plan) after completion of ten years of Secret Service employment and ten years of protection related experience. All uniformed USSS officers who were hired before January 1, 1984, are automatically covered under this retirement system. Participants in the DC Pension Plan make contributions of 7 percent of base pay with no matching contribution made by USSS. Annuitants of this plan receive benefit payments directly from the DC Pension Plan. USSS reimburses the District of Columbia for the difference between benefits provided to the annuitants, and payroll contributions received from current employees. This liability is presented as a component of the liability for military service and other retirement benefits in the accompanying Balance Sheet. SFFAS No. 5 requires the administrative entity (administrator) to report the actuarial liability. However, USSS adopted the provisions of SFFAS No. 5 because the administrator, the DC Pension Plan, is not a Federal entity and as such the liability for future funding would not otherwise be recorded in the Government-wide consolidated financial statements.

The primary actuarial assumptions used to determine the liability at September 30, 2008, are:

- life expectancy is based upon the RP 2000 Combined Healthy Mortality Table;
- cost of living increases are 3.5 percent annually;
- rates of salary increases are 3.5 percent annually;
- annual rate of investment return is 7.25 percent; and
- rates of withdrawal for active service by gender and age.

Total expenses related to the DC Pension Plan for the fiscal years ended September 30, 2008 and 2007, were $225 million and $215 million, respectively.

C. Actuarial FECA Liability

The actuarial Federal Employees' Compensation Act (FECA) liability represents the estimated liability for future workers' compensation and includes the expected liability for death, disability, medical, and miscellaneous costs for approved cases. Future workers' compensation estimates, generated from an application of actuarial procedures developed by DOL, for the future cost of approved compensation cases were approximately $1.8 billion and $1.7 billion at September 30, 2008 and 2007, respectively (unaudited).

17. Environmental and Disposal Liabilities

Environmental and disposal liabilities at September 30, 2008 and 2007 are $288 million and $275 million, respectively (unaudited). The Department is responsible to remediate its sites with environmental contamination, and is party to various administrative proceedings, legal actions, and tort claims which may result in settlements or decisions adverse to the Federal Government. The source of remediation requirements to determine the environmental liability is based on compliance with Federal, State, or local environmental laws and regulations. The major Federal laws covering environmental response, cleanup, and monitoring are the *Comprehensive Environmental Response,* *Compensation and Liability Act (P.L. 96-510)* and the *Resource Conservation and Recovery Act (P.L. 94-580)*.

The liabilities are primarily due to lighthouses, light stations, fuel storage tank program, buildings containing asbestos and/or lead based paint, firing ranges, fuels, solvents, industrial chemicals, and other environmental cleanup associated with normal operations of CBP, FLETC, and the U.S. Coast Guard. Potential environmental liabilities may exist in addition to the amounts accrued in the accompanying financial statements that are not presently estimable for the Plum Island Animal Disease Center, under S&T, due to the facility's age, old building materials used, and other materials associated with the facility's past use as a U.S. Army installation for coastline defense.

The Department has an unrecognized environmental liability of $89 million as of September 30, 2008 for U.S. Coast Guard vessels that have a reasonable possibility of being converted into marine artificial reefs; however, decisions on these have not occurred. This possibility exists for vessels over 90 feet in length after they are decommissioned. The preparation process includes the removal of all grease and buoyant material that might be harmful to the marine environment.

Cost estimates for environmental and disposal liabilities are subject to revision as a result of changes in inflation, technology, environmental laws and regulations, and plans for disposal.

18. Other Liabilities

Other Liabilities at September 30 consisted of the following (in millions):

Fiscal year ended September 30, 2008	Current	Non-Current	(Unaudited)
Intragovernmental:			
Due to the General Fund (Note 2)	$2,397	$ -	$2,397
Accrued FECA Liability	137	224	361
Advances from Others	138	-	138
Employer Benefits Contributions and Payroll Taxes	149	1	150
Other Intragovernmental Liabilities	106	-	106
Total Intragovernmental Other Liabilities	**$2,927**	**$225**	**$3,152**
Public:			
Accrued Payroll and Benefits (See B. below)	$1,736	$51	$1,787
Deferred Revenue and Advances from Others (See B. below)	1,931	1,149	3,080
Unliquidated Antidumping and Countervailing Duties (Notes 2, 3, and 7)	161	-	161
Insurance Liabilities (Note 20)	1,844	3,687	5,531
Refunds and Drawbacks (Note 2) (See B. below)	130	-	130
Contingent Legal Liabilities (Note 21)	232	142	374
Capital Lease Liability (Note 19)	19	70	89
Other	970	1	971
Total Other Liabilities with the Public	**$7,023**	**$5,100**	**$12,123**
Total Other Liabilities	**$9,950**	**$5,325**	**$15,275**

Fiscal year ended September 30, 2007	Current	Non-Current	(Unaudited) (Restated)
Intragovernmental:			
Due to the General Fund (Note 2)	$2,085	$ -	$2,085
Accrued FECA Liability	219	136	355
Advances from Others	70	-	70
Employer Benefits Contributions and Payroll Taxes	118	-	118
Other Intragovernmental Liabilities	57	-	57
Total Intragovernmental Other Liabilities	**$2,549**	**$136**	**$2,685**

Public:			
Accrued Payroll and Benefits (See B. below)	$1,534	$19	$1,553
Deferred Revenue and Advances from Others (See B. below)	1,682	1,045	2,727
Unliquidated Antidumping and Countervailing Duties (Notes 2 and 3)	514	- -	514
Injured Domestic Industries (Notes 2 and 3)	388	-	388
Insurance Liabilities (Note 20)	513	995	1,508
Refunds and Drawbacks (Note 2) (See B. below)	131	-	131
Contingent Legal Liabilities (Note 21)	224	1	225
Capital Lease Liability (Note 19)	50	57	107
Other	777	-	777
Total Other Liabilities with the Public	**$5,813**	**$2,117**	**$7,930**
Total Other Liabilities	**$8,362**	**$2,253**	**$10,615**

A. Intragovernmental Other Liabilities

Workers' Compensation. Claims incurred for the benefit of Department employees under FECA are administered by DOL and are ultimately paid by the Department. The accrued FECA liability represents money owed for current claims. Reimbursement to DOL on payments made occurs approximately two years subsequent to the actual disbursement. Budgetary resources for this intragovernmental liability are made available to the Department as part of its annual appropriation from Congress in the year in which the reimbursement takes place. Workers' compensation expense was $159 million and $154 million, respectively (unaudited), for the fiscal years ended September 30, 2008 and 2007.

Due to the General Fund. Amounts due to the Treasury General Fund represent duty, tax, and fees collected by CBP to be remitted to various General Fund accounts maintained by Treasury.

B. Other Liabilities with the Public

Accrued Payroll and Benefits. Accrued Payroll and Benefits at September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Accrued Funded Payroll and Benefits	$776	$656
Accrued Unfunded Leave	947	852
Unfunded Employment Related Liabilities	25	22
Other	39	23
Total Accrued Payroll and Benefits	**$1,787**	**$1,553**

Deferred Revenue and Advances from Others. Deferred Revenue and Advances From Others for the periods ended September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
USCIS Application Fees	$1,343	$1,132
FEMA Unexpired NFIP premium	1,723	1,582
Advances from Others	14	13
Total Deferred Revenue	**$3,080**	**$2,727**

USCIS requires payments of fees for applications or petitions for immigration and naturalization benefits at the time of filing. FEMA's deferred revenue relates to unearned NFIP premiums that are recognized over the term of the period of insurance coverage.

Unliquidated Antidumping and Countervailing Duties and Injured Domestic Industries. The *Continued Dumping and Subsidy Offset Act of 2000,(P.L. 106-387), Title X*, enacted in FY 2001 calls for CBP to collect and disburse monies received in connection with antidumping and countervailing duty orders and findings to qualifying IDI. Antidumping duties are collected when it is determined that a class or kind of foreign merchandise is being released into the U.S. economy at less than its fair value to the detriment of a U.S. industry. Countervailing duties are collected when it is determined that a foreign government is providing a subsidy to its local industries to manufacture, produce, or export a class or kind of merchandise for import into the U.S. commerce to the detriment of a U.S. industry. The duties will eventually be distributed to affected U.S. companies, pursuant to rulings by the U.S. Department of Commerce.

Refunds and Drawbacks. The liability for refunds and drawbacks for the fiscal years ended September 30, 2008 and 2007 were $130 million and $131 million, respectively.

Other Liabilities. Other public liabilities consist primarily of deposit and suspense fund liability.

19. Leases

A. Operating Leases

The Department leases various facilities and equipment under leases accounted for as operating leases. Leased items consist of offices, warehouses, vehicles, and other equipment. The majority of office space occupied by the Department is either owned by the Federal Government or is leased by GSA from commercial sources. The Department is not committed to continue paying rent to GSA beyond the period occupied, providing that proper advance notice to GSA is made and unless the space occupied is designated as unique to Department operations. However, it is expected the Department will continue to occupy and lease office space from GSA in future years and lease charges will be adjusted annually to reflect operating costs incurred by GSA.

As of September 30, 2008, estimated future minimum lease commitments under operating leases, some of which are cancelable, for equipment and GSA controlled leases were as follows (in millions) (unaudited):

	Land and Buildings	Vehicles and Equipment	Total
FY 2009	$1,087	$65	$1,152
FY 2010	1,158	69	1,227
FY 2011	1,184	74	1,258
FY 2012	1,217	79	1,296
FY 2013	1,243	74	1,317
After FY 2013	2,925	226	3,151
Total Future Minimum Lease Payments	**$8,814**	**$587**	**$9,401**

The estimated future lease payments for operating leases, some of which are cancelable, are based on payments made during the year ended September 30, 2008.

B. Capital Leases

The Department maintains capital leases for buildings and commercial software license agreements. The liabilities associated with capital leases and software license agreements are presented as other liabilities in the accompanying financial statements based upon the present value of the future minimum lease payments.

Certain license agreements are cancelable depending on future funding. Substantially all of the net present value of capital lease obligations and software license agreements will be funded from future sources. As of September 30, the summary of assets under capital lease were as follows (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Land and Buildings	$69	$69
Vehicles and Equipment	10	10
Software	152	152
Accumulated Amortization	(142)	(123)
Assets under Capital Lease, Net	**$89**	**$108**

As of September 30, 2008, estimated future minimum lease payments under capital leases, which were all non-GSA, were as follows (in millions) (unaudited):

	Land and Buildings	Software	Total
FY 2009	$6	$18	$24
FY 2010	6	18	24
FY 2011	6	-	6
FY 2012	6	-	6
FY 2013	6	-	6
After FY 2013	58	-	58
Total Future Minimum Lease Payments	88	36	124
Less: Imputed interest and Executory costs	32	3	35
Total Capital Lease Liability	**$56**	**$33**	**$89**

20. Insurance Liabilities

Insurance liabilities for the periods ended September 30, 2008 and 2007 were $5,531 million and $1,508 million, respectively (unaudited), and consist of primarily NFIP insurance liabilities.

The insurance liability for unpaid losses and related loss adjustment expenses and amounts paid for the year ended September 30 consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Beginning Balance	$1,508	$3,567
Change in incurred losses	4,942	(926)
Less: Amounts paid during current period	(919)	(1,133)
Total Insurance Liability at September 30	**$ 5,531**	**$1,508**

The NFIP insurance liability, the majority of the insurance liability reported, represents an estimate of NFIP based on the loss and loss adjustment expense factors inherent in the NFIP insurance underwriting operations experience and expectations. Estimation factors used by the insurance underwriting operations reflect current case basis estimates and give effect to estimates of trends in claim severity and frequency. These estimates are periodically reviewed, and adjustments, reflected in current operations, are made as deemed necessary.

In September 2008, Hurricane Ike made landfall in Texas. The severity of the hurricane, and time of occurrence relative to year-end, prevents FEMA from making a precise estimate of the related potential NFIP loss. Management estimates that the future payouts for flood insurance claims related to Hurricane Ike range between $3.3 billion and $8.2 billion. Management has accrued a most likely estimate of $5.5 billion in the accompanying financial statements.

NFIP premium rates are generally established for actuarially rated policies with the intent of generating sufficient premiums to cover losses and loss adjustment expenses of a historical average loss year and to provide a surplus to compensate the Insurance Underwriting Operations for the loss potential of an unusually severe loss year due to catastrophic flooding.

Notwithstanding the foregoing, subsidized rates have historically been charged on a countrywide basis for certain classifications of the insured. These subsidized rates produce a premium less than the loss and loss adjustment expenses expected to be incurred in a historical average loss year. The subsidized rates do not include a provision for losses from catastrophic flooding. Subsidized rates are used to provide affordable insurance on construction or substantial improvements started on or before December 31, 1974, or before the effective date of the initial Flood Insurance Rate Map (i.e., an official map of a community on which NFIP has delineated both the special hazard areas and the non-subsidized premium zones applicable to the community).

21. Commitments and Contingent Liabilities

A. Legal Contingent Liabilities

The estimated contingent liability recorded in the accompanying financial statements included with other liabilities for all probable and reasonably estimable litigation related claims at September 30, 2008, was $374 million, of which $94 million was funded. This increase of the probable and reasonably estimable litigation value is the result of a change in methodology used to evaluate Oil Spill Liability Trust Fund claims and a class action lawsuit challenging the legality of certain Department fees collected. The range of probable and estimable litigation is $374 million to $905 million. Asserted and pending legal claims for which loss is reasonably possible is estimated to range from $532 million to $1,001 million at September 30, 2008. The Department is subject to various other legal proceedings and claims. In management’s opinion, the ultimate resolution of other actions will not materially affect the Department’s financial position or net costs.

The estimated contingent liability recorded in the accompanying financial statements included with other liabilities for all probable and estimable litigation related claims at September 30, 2007, was $226 million, of which $46 million was funded. The range of probable and estimable litigation is $226 million to $587 million. Asserted and pending legal claims for which loss is reasonably possible is estimated to range from $35 million to $561 million at September 30, 2007.

The nature of probable and reasonably possible claims is litigation related to the *Federal Tort Claims Act (P.L. 79-601)*, Oil Spill Liability Trust Fund, and various customs laws and regulations. In addition, the Department is subject to various other legal proceedings and claims. In management’s opinion, the ultimate resolution of other actions will not materially affect the Department’s financial position or net costs.

DHS management and general legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing contingencies related to legal proceedings that are pending against DHS, or unasserted claims that may result in such proceedings, general legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims, as well as the perceived merits of the amounts of relief sought or expected to be brought therein.

If the assessment of the loss contingency indicates that it is probable that a material liability has been incurred and the amount of the liability can be estimated, then the estimated liability is accrued in the financial statements regardless of the source of funding used to pay the liability. If the assessment indicates that a potentially material contingent liability is not probable but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss, if determinable and material, is disclosed.

B. Duty and Trade Refunds

There are various trade related matters that fall under the jurisdiction of other Federal agencies, such as the U.S. Department of Commerce, which may result in refunds of duties, taxes, and fees collected by CBP. Until a decision is reached by the other Federal agencies, CBP does not have sufficient information to estimate a contingent liability amount, if any, for trade related refunds under jurisdiction of other Federal agencies in addition to the amount accrued on the accompanying financial statements. All known duty and trade refunds as of September 30, 2008 and 2007, have been recorded.

C. Loaned Aircraft and Equipment

The Department is generally liable to DOD for damage or loss to aircraft on loan to CBP and vessels on loan to the U.S. Coast Guard. As of September 30, 2008 and September 30, 2007, CBP had 16 aircraft loaned from DOD with a replacement value of up to $25 million (unaudited) per aircraft. As of September 30, 2008, the U.S. Coast Guard had three vessels loaned from DOD with a replacement value of $36 million (unaudited). As of September 30, 2007, the U.S. Coast Guard had five vessels loaned from DOD with a replacement value of $60 million (unaudited).

D. Other Contractual Arrangements

In addition to future lease commitments disclosed in Note 19, the Department is committed under contractual agreements for goods and services that have been ordered but not yet received (undelivered orders) at fiscal year-end. Aggregate undelivered orders for all Department activities are disclosed in Note 30. In accordance with Public Law 101-510, the Department is required to automatically cancel obligated and unobligated balances of appropriated funds five years after a fund expires. Obligations that have not been paid at the time an appropriation is cancelled may be paid from an unexpired appropriation that is available for the same general purpose. As of September 30, 2008, DHS estimates total payments related to cancelled appropriations to be $44 million (unaudited) of which $41 million (unaudited) for contractual arrangements may require future funding. As of September 30, 2007, DHS estimates $47 million (unaudited) in obligations related to cancelled appropriations for which the Department has a contractual obligation for payment, as well as an estimated $14 million (unaudited) for contractual arrangements which may require future funding.

TSA entered into a number of *Letters of Intent for Modifications to Airport Facilities* with eight major airports in which TSA may reimburse the airports for 75 percent (estimated total of $1,157 million) of the cost to modify the facilities for security purposes. These Letters of Intent would not obligate TSA until funds have been appropriated and obligated. TSA has received $200 million (unaudited) in FY 2008 and $162 million (unaudited) in FY 2007 under this program, which is available for payment to the airports upon approval by TSA of an invoice for the modification costs incurred. As of September 30, 2008, TSA has received invoices or documentation for costs incurred totaling $716 million (unaudited) related to these agreements. TSA has accrued $49.9 million for the invoices or documentation received but not paid.

22. Earmarked Funds

Earmarked funds are financed by specifically identified revenues, often supplemented by other financing sources, which remain available over time. These specifically identified revenues and other financing sources are required by statute to be used for designated activities or purposes. SSFAS No. 27, *Identifying and Reporting Earmarked Funds*, defines the following three critieria for determining an earmarked fund: 1) a statute committing the Federal Government to use specifically identifed revenues and other financing sources only for designated activities, benefits, or purposes; 2) explicit authority for the earmarked fund to retain revenues and other financing sources not used in the current period for future use to finance the designated activities, benefits, or purposes; and 3) a requirement to account for and report on the receipt, use, and retention of the revenues and other financing sources that distinguished the earmarked fund from the Federal Government's general revenues.

There are no eliminations within the earmarked funds. Earmarked funds consisted of the following (in millions) (unaudited):

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	All Other Earmarked Funds	Total Earmarked Funds
Balance Sheet as of September 30, 2008						
ASSETS						
Fund Balance with Treasury	$768	$9	$1,716	$829	$1,515	$4,837
Investments, Net	-	1,945	-	-	1,158	3,103
Taxes Receivable	75	-	-	-	-	75
Other	104	20	38	536	360	1,058
Total Assets	**$947**	**$1,974**	**$1,754**	**$1,365**	**$3,033**	**$9,073**
LIABILITIES						
Other Liabilities	$100	$1,206	$1,716	$25,013	$375	$28,410
Total Liabilities	**$100**	**$1,206**	**$1,716**	**$25,013**	**$375**	**$28,410**
NET POSITION						
Cumulative Results of Operations	847	768	38	(23,648)	2,658	(19,337)
Total Liabilities and Net Position	**$947**	**$1,974**	**$1,754**	**$1,365**	**$3,033**	**$9,073**

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	All Other Earmarked Funds	Total Earmarked Funds
Statement of Net Cost for the Year Ended September 30, 2008						
Gross Program Costs	$376	$ -	$2,138	$6,671	$1,381	$10,566
Less: Earned Revenues	-	-	(2,227)	(2,921)	(656)	(5,804)
Net Cost of Operations	**$376**	**$ -**	**$(89)**	**$3,750**	**$725**	**$4,762**
Statement of Changes in Net Position for the Year Ended September 30, 2008						
Net Position Beginning of Period	$788	$771	$(4)	$(19,899)	$2,108	$(16,236)
Net Cost of Operations	(376)	-	89	(3,750)	(725)	(4,762)
Non-exchange Revenue	1,925	710	-	-	1,188	3,823
Other	(1,490)	(713)	(47)	1	87	(2,162)
Change in Net Position	59	(3)	42	(3,749)	550	(3,101)
Net Position, End of Period	**$847**	**$768**	**$38**	**$(23,648)**	**$2,658**	**$(19,337)**

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	All Other Earmarked Funds	Total Earmarked Funds
Balance Sheet as of September 30, 2007						
ASSETS						
Fund Balance with Treasury	$730	$8	$1,245	$656	$1,061	$3,700
Investments, Net	-	1,845	-	-	933	2,778
Taxes Receivables	69	-	-	-	-	69
Other	76	19	267	497	247	1,106
Total Assets	**$875**	**$1,872**	**$1,512**	**1,153**	**$2,241**	**$7,653**
LIABILITIES						
Other Liabilities	$87	$1,101	$1,516	$21,054	$131	$23,889
Total Liabilities	**$87**	**$1,101**	**$1,516**	**$21,054**	**$131**	**$23,889**
NET POSITION						
Cumulative Results of Operations	$788	$771	$(4)	$(19,901)	$2,110	$(16,236)
Total Liabilities and Net Position	**$875**	**$1,872**	**$1,512**	**$1,153**	**$2,241**	**$7,653**

	Customs User Fees	Sport Fish Restoration Boating Trust Fund	Immigration Examination Fees	National Flood Insurance Program	All Other Earmarked Funds	Total Earmarked Funds
Statement of Net Cost for the Year Ended September 30, 2007						
Gross Program Costs	$369	$ -	$1,681	$799	$1,163	$4,012
Less: Earned Revenues	-	(76)	(1,669)	(2,622)	(426)	(4,793)
Net Cost of Operations	**$369**	**$(76)**	**$12**	**$(1,823)**	**$737**	**$(781)**
Statement of Changes in Net Position for the Year Ended September 30, 2007						
Net Position Beginning of Period	$798	$693	$8	$(21,725)	$1,582	$(18,644)
Net Cost of Operations	(369)	76	(12)	1,823	(737)	781
Non-exchange Revenue	1,808	628	-	-	1,167	3,603
Other	(1,450)	(626)	-	1	99	(1,976)
Change in Net Position	(11)	78	(12)	1,824	529	2,408
Net Position, End of Period	**$787**	**$771**	**$(4)**	**$(19,901)**	**$2,111**	**$(16,236)**

Customs User Fees

In April 1986, the President signed the *Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA)*, which authorized CBP to collect user fees for certain services. The law initially established processing fees for air and sea passengers, commercial trucks, rail cars, private vessels and aircraft, commercial vessels, dutiable mail packages, and CBP broker permits. An additional fee category, contained in tax reform legislation, for processing barges and bulk carriers for Canada and Mexico, was added later that year. The collection of COBRA fees for CBP services began on July 7, 1986.

In addition to the collection of user fees, other changes in CBP procedures were enacted due to the COBRA statute. Most importantly, provisions were included for providing non-reimbursable inspectional overtime services and paying for excess pre-clearance costs from COBRA user fee collections.

The *Customs and Trade Act of 1990* amended the COBRA legislation to provide for the hiring of inspectional personnel, the purchasing of equipment, and the covering of related expenses with any surplus monies available, after overtime and excess pre-clearance costs are satisfied. Expenditures from the surplus can only be used to enhance the service provided to those functions for which fees are collected. This legislation took effect on October 1, 1990.

19 USC Section 58c contains the fees for certain customs services. The authority to use these funds is contained in the annual DHS Appropriations Act.

Access to COBRA surplus funds provides CBP with additional resources to assist in the accomplishment of CBP's mission. Increased staffing and equipment have enhanced the manager's flexibility in dealing with the ever-increasing demands of the trade and travel communities.

Sport Fish Restoration Boating Trust Fund (SFRBTF)

The SFRBTF, previously known as the Aquatic Resources Trust Fund (ARTF), was created by Section 1016 of the *Deficit Reduction Act of 1984 (P.L. 98-369)*. Two funds were created under this act, the Boat Safety Account and the Sport Fish Restoration Account. The SFRBTF has been the source of budget authority for the Boat Safety program for many years through the transfer of appropriated funds. The SFRBTF is a Treasury-managed fund and provides funding to states and other entities to promote boat safety and conservation of U.S. recreational waters.

This fund receives revenues transferred from custodial activities of the Treasury which are deposited in a Treasury account. The revenues are derived from a number of sources including motor boat fuel tax, excise taxes on sport fishing equipment, and import duties on fishing tackle and yachts. Three agencies share in the available portion of the revenue, Fish and Wildlife Service in the U.S. Department of Interior (DOI) (14X8151), the U.S. Army Corps of Engineers (COE) (96X8333), and U.S. Coast Guard (70X8149).

The most recent reauthorization of SFRBTF and expenditure of Boat Safety funds for the National RBS Program was enacted in 2005 in the *Safe, Accountable, Flexible, and Efficient Transportation Equity Act: A Legacy for Users or SAFETEA-LU (P.L. 109-59)* and the *Sportfishing and Recreational Boating Safety Amendments Act of 2005 (P.L. 109-74)*.

Immigration Examination Fees

In 1988, Congress established the Immigration Examination Fee Account (IEFA) and the fees deposited into the IEFA have been the primary source of funding for providing immigration and naturalization benefits, and other benefits as directed by Congress. The *Immigration and Nationality Act* (INA) section 286(m) provides for the collection of fees at a level that will ensure recovery of the full costs of providing adjudication and naturalization services, including the costs of providing similar services without charge to asylum applicants and other immigrants. The INA also states that the fees may recover administrative costs. This revenue remains available to provide immigration and naturalization benefits and allows the collection, safeguarding, and accounting for fees.

The primary sources of revenue are the application and petition fees that are collected during the course of the fiscal year and deposited into the Immigration Examinations Fee Account (Treasury Account Fund Symbol (TAFS) 70X5088). In addition, USCIS provides specific services to other Federal agencies, such as production of Border Crossing Cards for the U.S. Department of State, that result in the collection of other revenues that are the result of intragovernmental activities.

During FY 2007, two events occurred that impacted fee revenue resources, including the fee increase and the visa open window for employment benefits. Both events caused a surge in applications received and fees collected during the fourth quarter of FY 2007. Increased collections from the fee increase have continued during FY 2008.

National Flood Insurance Program

The National Flood Insurance Program (NFIP) was established by the *National Flood Insurance Act of 1968*. The purpose of NFIP is to better indemnify individuals for flood losses through insurance, reduce future flood damages through State and community floodplain management regulations, and reduce Federal expenditures for disaster assistance and flood control.

The *Flood Disaster Protection Act of 1973* expanded the authority of FEMA and its use of the NFIP to grant premium subsidies as an additional incentive to encourage widespread state, community, and property owner acceptance of the program requirements.

The *National Flood Insurance Reform Act of 1994* reinforced the objective of using insurance as the preferred mechanism for disaster assistance by expanding mandatory flood insurance purchase requirements and by effecting a prohibition on further flood disaster assistance for any property where flood insurance, after having been mandated as a condition for receiving disaster assistance, is not mandated.

The *Bunning-Bereuter-Blumenauer Flood Insurance Reform Act (FIRA) of 2004* provides additional tools for addressing the impact of repetitive loss properties on the National Flood Insurance Fund. It introduced a pilot project though FY 2009 that defines severe repetitive loss properties, authorizes additional funds for mitigation projects, and mandates a 50 percent increase of premiums for property owners who decline a mitigation offer, along with an appeal process. It also modifies the Flood Mitigation Assistance (FMA) Program by doubling the annual authorized funding level and directing it to give priority to those properties that are in the best interest of the National Flood Insurance Fund.

NFIP requires all partners (Write Your Own (WYO) Companies) in the program to submit financial statements and statistical data to the Bureau & Statistical Agent (B&SA) on a monthly basis. This information is reconciled and the WYO companies are required to correct any variances.

This program is an insurance program for which the Department pays claims to policyholders whose houses have been flooded. The WYO companies that participate in the program have authority to use Departmental funds (revenue and other financing sources) to respond to the obligations of the policyholders. Congress has mandated that the NFIP funds are to only be used to pay claims caused by flooding.

The NFIP sources of revenue and other financing comes from premiums collected to insure policyholder’s homes and the borrowing authority provided to our program from Congress. The resources are inflows to the Government and are not the result of intragovernmental flows.

All Other Earmarked Funds

The balances and activity reported for all other earmarked funds result from the funds listed below. Information related to these earmarked funds can be located in the Department’s appropriations legislation or the statutes referenced.

- 70X0715 Radiological Emergency Preparedness Program, Emergency Preparedness and Response, Department of Homeland Security

- 70X5089 U.S. Customs and Border Protection, Land Border Inspection Fees, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70_5087 U.S. Customs and Border Protection, Immigration User Fees, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5126 Breach Bond/Detention Fund, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5378 Student and Exchange Visitor Program, Border and Transportation Security, Department of Homeland Security; 110 Stat. 3009-706, Sec. (e)(4)(B)
- 70X5382 Immigration User Fee Account, BICE, Department of Homeland Security; 116 Stat. 2135
- 70X5385 Aviation Security Capital Fund, Transportation Security Administration, Department of Homeland Security; 117 Stat. 2567(h)(1)
- 70_5389 H-1B and L Fraud Prevention and Detection Account, U.S. Citizenship and Immigration Service, Department of Homeland Security; 8 U.S.C. § 1356 (s)
- 70X5390 Unclaimed Checkpoint Money, Transportation Security Administration, Department of Homeland Security; 118 Stat. 1317-1318, Sec.515(a)
- 70X5451 Immigration Enforcement Account, Border and Transportation Security, Department of Homeland Security; 116 Stat. 2135
- 70X5545 Airport Checkpoint Screening Fund, Transportation Security Administration, Department of Homeland Security; P.L. 110-161
- 70_5694 User Fees, Small Airports, U.S. Customs Service, Department of Homeland Security; 116 Stat. 2135
- 70X8149 Boat Safety, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8244 Gifts and Donations, Department Management, Department of Homeland Security; 116 Stat. 2135 (FEMA REPORTED)
- 70X8312 Oil Spill Liability Trust Fund, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70_8314 Trust Fund Share of Expenses, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8349 Oil Spill Recovery, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8533 General Gift Fund, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8870 Harbor Maintenance Fee Collection, U.S. Customs Service, Department of Homeland Security; 116 Stat. 2135
- 20X8185 Oil Spill Liability Trust Fund; 103 Stat. 2363, 2364
- 70_5106 H-1 B Nonimmigrant Petitioner Account, Department of Homeland Security; 116 Stat. 2135
- 70X8360 Gifts and Bequests, Federal Law Enforcement Training Center, Department of Homeland Security; 116 Stat. 2135
- 70X8420 Surcharge Collections, Sales of Commissary Stores, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X8428 Coast Guard Cadet Fund, U.S. Coast Guard, Department of Homeland Security; 116 Stat. 2135
- 70X5543 International Registered Traveler Program Fund, U.S. Customs and Border Protection, Department of Homeland Security; 121 Stat. 2091-2092

23. Intragovernmental Costs and Exchange Revenue

For the year ended September 30, 2008 (in millions) (Unaudited)

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
U.S. Customs and Border Protection			
Gross Cost	$2,463	$7,320	$9,783
Less Earned Revenue	(55)	(105)	(160)
Net Cost	**2,408**	**7,215**	**9,623**
U.S. Coast Guard			
Gross Cost	702	8,806	9,508
Less Earned Revenue	(203)	(262)	(465)
Net Cost	**499**	**8,544**	**9,043**
U.S. Citizenship and Immigration Services			
Gross Cost	660	1,524	2,184
Less Earned Revenue	(5)	(2,210)	(2,215)
Net Cost	**655**	**(686)**	**(31)**
Federal Emergency Management Agency			
Gross Cost	1,597	16,903	18,500
Less Earned Revenue	(80)	(2,947)	(3,027)
Net Cost	**1,517**	**13,956**	**15,473**
Federal Law Enforcement Training Center			
Gross Cost	32	415	447
Less Earned Revenue	(38)	(2)	(40)
Net Cost	**(6)**	**413**	**407**
National Protection and Programs Directorate			
Gross Cost	337	535	872
Less Earned Revenue	(1)	-	(1)
Net Cost	**336**	**535**	**871**
U.S. Immigration and Customs Enforcement			
Gross Cost	1,315	4,170	5,485
Less Earned Revenue	(822)	(106)	(928)
Net Cost	**493**	**4,064**	**4,557**
Office of Health Affairs			
Gross Cost	119	38	157
Less Earned Revenue	-	-	-
Net Cost	**119**	**38**	**157**

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
Departmental Operations and Other			
Gross Cost	$380	$936	$1,316
Less Earned Revenue	(1)	-	(1)
Net Cost	**379**	**936**	**1,315**
U.S. Secret Service			
Gross Cost	427	1,320	1,747
Less Earned Revenue	(11)	-	(11)
Net Cost	**416**	**1,320**	**1,736**
Science and Technology Directorate			
Gross Cost	444	332	776
Less Earned Revenue	(6)	-	(6)
Net Cost	**438**	**332**	**770**
Transportation Security Administration			
Gross Cost	1,230	5,392	6,622
Less Earned Revenue	(1)	(2,384)	(2,385)
Net Cost	**1,229**	**3,008**	**4,237**
Total Department of Homeland Security			
Gross Cost	9,706	47,691	57,397
Less Earned Revenue	(1,223)	(8,016)	(9,239)
Net Cost	**$8,483**	**$39,675**	**$48,158**

For the year ended September 30, 2007 (in millions) (Unaudited) (Restated)

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
U.S. Customs and Border Protection			
Gross Cost	$2,089	$6,109	$8,198
Less Earned Revenue	(46)	(111)	(157)
Net Cost	**2,043**	**5,998**	**8,041**
U.S. Coast Guard			
Gross Cost	1,188	9,465	10,653
Less Earned Revenue	(372)	(120)	(492)
Net Cost	**816**	**9,345**	**10,161**
U.S. Citizenship and Immigration Services			
Gross Cost	569	1,162	1,731
Less Earned Revenue	(13)	(1,646)	(1,659)
Net Cost	**556**	**(484)**	**72**
Federal Emergency Management Agency			
Gross Cost	2,579	11,693	14,272
Less Earned Revenue	(98)	(2,744)	(2,842)
Net Cost	**2,481**	**8,949**	**11,430**
Federal Law Enforcement Training Center			
Gross Cost	29	373	402
Less Earned Revenue	(38)	(3)	(41)
Net Cost	**(9)**	**370**	**361**
National Protection and Programs Directorate			
Gross Cost	438	417	855
Less Earned Revenue	-	-	-
Net Cost	**438**	**417**	**855**
U.S. Immigration and Customs Enforcement			
Gross Cost	1,168	3,723	4,891
Less Earned Revenue	(783)	(117)	(900)
Net Cost	**385**	**3,606**	**3,991**
Office of Health Affairs			
Gross Cost	109	4	113
Less Earned Revenue	-	-	-
Net Cost	**109**	**4**	**113**

Directorates and Other Components	Intragovernmental Consolidated	With the Public	Total
Departmental Operations and Other			
Gross Cost	$442	$762	$1,204
Less Earned Revenue	(2)	(1)	(3)
Net Cost	**440**	**761**	**1,201**
U.S. Secret Service			
Gross Cost	487	1,202	1,689
Less Earned Revenue	(16)	-	(16)
Net Cost	**471**	**1,202**	**1,673**
Science and Technology Directorate			
Gross Cost	583	404	987
Less Earned Revenue	(14)	-	(14)
Net Cost	**569**	**404**	**973**
Transportation Security Administration			
Gross Cost	1,393	4,963	6,356
Less Earned Revenue	(2)	(2,297)	(2,299)
Net Cost	**1,391**	**2,666**	**4,057**
Total Department of Homeland Security			
Gross Cost	11,074	40,277	51,351
Less Earned Revenue	(1,384)	(7,039)	(8,423)
Net Cost	**$9,690**	**$33,238**	**$42,928**

Intragovernmental costs represent exchange transactions made between two reporting entities within the Federal Government and are presented separately from costs with the public (exchange transactions made between the reporting entity and a non-Federal entity). Intragovernmental exchange revenue is disclosed separately from exchange revenue with the public. The criteria used for this classification requires that the intragovernmental expenses relate to the source of goods and services purchased by the reporting entity and not to the classification of related revenue. For example, with “exchange revenue with the public,” the buyer of the goods or services is a non-Federal entity. With “intragovernmental costs,” the buyer and seller are both Federal entities. If a Federal entity purchases goods or services from another Federal entity and sells them to the public, the exchange revenue would be classified as “with the public,” but the related costs would be classified as “intragovernmental.” The purpose of this classification is to enable the Federal Government to provide consolidated financial statements, and not to match public and intragovernmental revenue with costs that are incurred to produce public and intragovernmental revenue.

24. Suborganization Costs by DHS Goals

Operating costs are summarized in the Statement of Net Cost by responsibility segment, as applicable to the reporting period. The net cost of operations is the gross (i.e., total) cost incurred by the Department, less any exchange (i.e., earned) revenue. A responsibility segment is the Component that carries out a mission or major line of activity, and whose managers report directly to Departmental Management.

To integrate performance and financial information, as required by the *President's Management Agenda* and the *Government Performance and Results Act*, a supplemental schedule of net cost is included in this note, in which costs by Component are allocated to Departmental strategic goals. In September 2008, the Department issued Fiscal Year 2008 – 2013 Strategic Plan, which is used as the basis for integrating FY 2008 net costs to performance information for all Components with the exception of CBP. Due to the late issuance of the new strategic goals and insufficient time to fully reprogram them into CBP's complex cost management system, CBP's FY 2008 net cost information is presented based on the Secretary's two year goals used in FY 2007. In addition, FY 2007 net cost information is also presented based on the Secretary's two year goals consistent with the FY 2007 Annual Financial Report and Annual Performance Report, and has not been reclassified to be consistent with the current year presentation based on the new strategic goals.

Net Costs of Department Sub-organizations by Strategic Goals (in millions)
For the year ended September 30, 2008 (Unaudited)

	Protect our Nation from Dangerous People	Protect our Nation from Dangerous Goods	Protect Critical Infrastructure	Strengthen Our Nation's Preparedness and Emergency Response Capabilities	Strengthen and Unify DHS Operations and Management	TOTAL
U.S. Customs and Border Protection	$9,623	$ -	$ -	$ -	$ -	**$9,623**
U.S. Coast Guard	1,587	1,159	4,914	1,383	-	**9,043**
U.S. Citizenship and Immigration Services	(31)	-	-	-	-	**(31)**
Federal Emergency Management Agency	-	-	6	15,467	-	**15,473**
Federal Law Enforcement Training Center	-	-	-	407	-	**407**
National Protection and Programs Directorate	290	-	554	27	-	**871**
U.S. Immigration and Customs Enforcement	4,252	-	305	-	-	**4,557**
Office of Health Affairs	-	126	-	31	-	**157**
Departmental Operations and Other	-	257	-	-	1,058	**1,315**
U.S. Secret Service	-	-	1,736	-	-	**1,736**
Science and Technology Directorate	40	432	85	213	-	**770**
Transportation Security Administration	3,184	862	191	-	-	**4,237**
TOTAL Department	**$18,945**	**$2,836**	**$7,791**	**$17,528**	**$1,058**	**$48,158**

Net Costs of Department Sub-organizations by Secretary's Goals (in millions)
For the year ended September 30, 2007 (Unaudited) (Restated)

	Protect our Nation from Dangerous People	Protect our Nation from Dangerous Goods	Protect Critical Infrastructure	Emergency Response System and Culture of Preparedness	Strengthen and Unify DHS Operations and Management	TOTAL
U.S. Customs and Border Protection	$8,041	$ -	$ -	$ -	$ -	**$8,041**
U.S. Coast Guard	2,798	-	5,999	1,364	-	**10,161**
U.S. Citizenship and Immigration Services	72	-	-	-	-	**72**
Federal Emergency Management Agency	-	-	-	11,430	-	**11,430**
Federal Law Enforcement Training Center	-	-	-	361	-	**361**
National Protection and Programs Directorate	285	-	539	31	-	**855**
U.S. Immigration and Customs Enforcement	4,219	-	(228)	-	-	**3,991**
Office of Health Affairs	-	56	-	57	-	**113**
Departmental Operations and Other	-	106	-	-	1,095	**1,201**
U.S. Secret Service	-	-	1,673	-	-	**1,673**
Science and Technology Directorate	30	475	157	311	-	**973**
Transportation Security Administration	587	-	3,470	-	-	**4,057**
TOTAL Department	**$16,032**	**$637**	**$11,610**	**$13,554**	**$1,095**	**$42,928**

25. Apportionment Categories of Obligations Incurred: Direct versus Reimbursable Obligations

Apportionment categories are determined in accordance with the guidance provided in OMB Circular A-11, *Preparation, Submission and Execution of the Budget*. Category A represents resources apportioned for calendar quarters. Category B represents resources apportioned for other time periods, for activities, projects, or objectives, or for any combination thereof (in millions).

Year Ended September 30, 2008 (Unaudited):	**Apportionment Category A**	**Apportionment Category B**	**Exempt from Apportionment**	**Total**
Obligations Incurred - Direct	$32,618	$23,206	$1,001	$56,825
Obligations Incurred - Reimbursable	3,631	5,023	10	8,664
Total Obligations Incurred	**$36,249**	**$28,229**	**$1,011**	**$65,489**

Year Ended September 30, 2007 (Unaudited):	**Apportionment Category A**	**Apportionment Category B**	**Exempt from Apportionment**	**Total**
Obligations Incurred - Direct	$30,738	$24,335	$1,593	$56,666
Obligations Incurred - Reimbursable	4,583	737	-	5,320
Total Obligations Incurred	**$35,321**	**$25,072**	**$1,593**	**$61,986**

The increase in obligations incurred was the result of obligation activity against increased funding as a result of hurricane flooding.

26. Available Borrowing Authority

The Department, through FEMA's NFIP, at the beginning of FY 2008 had available borrowing authority of $3,465 million (unaudited). During FY 2008, FEMA used $50 million in borrowing authority; which leaves a balance of $3,415 million. For FY 2007, FEMA had a beginning balance of used $4,230 million in borrowing authority; reductions of $70 million and used $695 million leaving a balance of $3,465 million. DADLP annually requests borrowing authority to cover the principal amount of direct loans not to exceed $25 million less the subsidy due from the program account.

27. Permanent Indefinite Appropriations

Permanent indefinite appropriations refer to the appropriations that result from permanent public laws, which authorize the Department to retain certain receipts. The amount appropriated depends upon the amount of the receipts rather than on a specific amount. The Department has two permanent indefinite appropriations as follows:

- CBP has a permanent and indefinite appropriation, which is used to disburse tax and duty refunds and duty drawbacks. Although funded through appropriations, refund and drawback activity is, in most instances, reported as custodial activity of the Department. Refunds are custodial revenue-related activity in that refunds are a direct result of overpayments of taxes, duties, and fees. Federal tax revenue received from taxpayers is not available for use in the operation of the Department and is not reported on the Statement of Net Cost. Likewise, the refunds of overpayments are not available for use by the Department in its operations.

- USSS has a permanent and indefinite appropriation, which is used to reimburse the DC Pension Plan for the difference between benefits to participants in the DC Pension Plan (see Note 16), and payroll contributions received from current employees.

These appropriations are not subject to budgetary ceilings established by Congress. CBP's refunds payable at year-end are not subject to funding restrictions.

28. Legal Arrangements Affecting the Use of Unobligated Balances

Unobligated balances whose period of availability has expired are not available to fund new obligations. Expired unobligated balances are available to pay for current period adjustments to obligations incurred prior to expiration. For a fixed appropriation account, the balance can be carried forward for five fiscal years after the period of availability ends. At the end of the fifth fiscal year, the account is closed and any remaining balance is canceled and returned to Treasury. For a no-year account, the unobligated balance is carried forward indefinitely until: 1) specifically rescinded by law; or 2) the head of the agency concerned or the President determines that the purposes for which the appropriation was made have been carried out and disbursements have not been made against the appropriation for two consecutive years.

Included in the cumulative results of operations for special funds is $1.1 billion (unaudited) at September 30, 2008 and 2007 that represents the Department's authority to assess and collect user fees relating to merchandise and passenger processing; to assess and collect fees associated with services performed at certain small airports or other facilities; retain amounts needed to offset costs associated with collecting duties; and taxes and fees for the Government of Puerto Rico. These special fund balances are restricted by law in their use to offset specific costs incurred by the Department. Part of the passenger fees in the User Fees Account, totaling approximately $735 million (unaudited) and $758 million (unaudited) at September 30, 2008 and 2007, respectively, is restricted by law in its use to offset specific costs incurred by the Department and are available to the extent provided in Department Appropriation Acts.

The entity trust fund balances result from the Department's authority to use the proceeds from general order items sold at auction to offset specific costs incurred by the Department relating to their sale, to use available funds in the Salaries and Expense Trust Fund to offset specific costs for expanding border and port enforcement activities, and to use available funds from the Harbor Maintenance Fee Trust Fund to offset administrative expenses related to the collection of the Harbor Maintenance Fee.

29. Explanation of Differences between the Statement of Budgetary Resources and the Budget of the U.S. Government

The table below documents the material differences between the FY 2007 Statement of Budgetary Resources (SBR) and the actual amounts reported for FY 2007 in the Budget of the U.S. Government. Since the FY 2008 financial statements will be reported prior to the release of the

Budget of the U.S. Government, DHS is reporting for FY 2007 only. Typically, the Budget of the U.S. Government with the FY 2008 actual data is published in February of the subsequent year. Once published the FY 2008 actual data will be available on the OMB website at: www.whitehouse.gov/omb.

(in millions)	Budgetary Resources	Obligations Incurred	Distributed Offsetting Receipts	Net Outlays
FY 2007 Actual Balances per the FY 2009 President's Budget	**$75,305**	**$59,920**	**$5,112**	**$44,333**
Reconciling Items:				
Accounts that are expired that are not included in Budget of the United States.	1,437	151		
Distributed Offsetting Receipts not included in the Budget of the United States.				(4,952)
Refunds and drawbacks not included in the Budget of the United States.	1,538	1,538		1,538
Byrd Program (Continued Dumping and Subsidy Offset) not included in the Budget of the United States.	954	381		381
Various unexpired programs that are not included in the Budget of the United States	559			40
Immigration Examination fees that were captured as deferred revenue			(404)	
President's Budget outlays that were overstated due to misclassification as an offsetting receipt			250	(250)
Miscellaneous Differences	55	(4)	(6)	
Per the 2007 SBR (Unaudited) (Restated)	**$79,848**	**$61,986**	**$4,952**	**$41,090**

30. Undelivered Orders, End of Period

An undelivered order exists when a valid obligation has occurred and funds have been reserved, but the goods or services have not been delivered. Undelivered orders for the periods ended September 30, 2008 and 2007 were $41,855 million (unaudited) and $38,172 million (unaudited) (restated), respectively.

31. Explanation for the Difference between the Appropriations Received reported on the Statement of Budgetary Resources and on the Statement of Changes in Net Position

The SBR reported $57,653 million (unaudited) for appropriations received for FY 2008. This balance does not agree to the balance reported on the Statement of Changes in Net Position (SCNP) of $50,253 million (unaudited) for FY 2008. The difference is primarily related to: 1) $6,642 million in certain trust and special fund receipts not reflected in the unexpended appropriations section of the SCNP; 2) $(62) million for the decrease in amounts appropriated from certain Treasury-managed trust funds; 3) $1,000 million related to refunds and drawbacks; and 4) $(180) million for receipts unavailable for obligations upon collection from certain trust and special funds.

The SBR reported $46,491 million (unaudited) for appropriations received for FY 2007. This balance does not agree to the balance reported on the SCNP of $39,520 million (unaudited) for FY 2007. The difference is primarily related to: 1) $5,718 million in certain trust and special fund receipts not reflected in the unexpended appropriations section of the SCNP; 2) $(34) million for the decrease in amounts appropriated from certain Treasury-managed trust funds; 3) $1,611 million related to refunds and drawbacks; 4) $(324) million for receipts unavailable for obligations upon collection from certain trust and special funds; and 5) $1 million for a temporary reduction/cancellation returned by appropriation.

32. Custodial Revenues

The Department collects revenue from a variety of duties, excise taxes, and various other fees. Collection activity primarily relates to current year activity. Non-entity revenue reported on the Department's Statement of Custodial Activity include duties, excise taxes, and various non-exchange fees collected by CBP and USCIS that are subsequently remitted to the Treasury General Fund or to other Federal agencies. CBP assesses duties, taxes, and fees on goods and merchandise brought into the United States from foreign countries. At the time an importer's merchandise is brought into the United States, the importer is required to file entry documents. Generally, within ten working days after release of the merchandise into the United States commerce, the importer is to submit an entry document with payment of estimated duties, taxes, and fees.

The significant types of non-entity accounts receivable (custodial revenues as presented in the Statement of Custodial Activity) are described below.

- **Duties:** amounts collected on imported goods collected on behalf of the Federal Government.
- **Excise taxes:** amounts collected on imported distilled spirits, wines, and tobacco products.
- **User fees:** amounts designed to maintain U.S. harbors and to defray the cost of other miscellaneous service programs. User fees include application fees collected from employers sponsoring nonimmigrant petitions.

- **Fines and penalties:** amounts collected for violations of laws and regulations.

- **Refunds:** overpayments of duties, taxes, fees, and interest to an importer/exporter for which the importer/exporter needs to reimburse the payer. Refunds include drawback remittance paid when imported merchandise, for which duty was previously paid, is exported from the United States.

Tax disbursements from the refunds and drawbacks account, broken out by revenue type and by tax year, were as follows for the fiscal years ended September 30, 2008 and 2007 (in millions) (unaudited):

2008 Tax Disbursements

	Tax Year				
	2008	2007	2006	2005	Prior Years
Customs duties	$815	$162	$54	$27	$238
Total nonexchange revenue refunded	815	162	54	27	238
Exchange revenue refunded	-	-	- -	-	
Total tax refunds and drawbacks disbursed	**$815**	**$162**	**$54**	**$27**	**$238**

2007 Tax Disbursements

	Tax Year				
	2007	2006	2005	2004	Prior Years
Customs duties	$5,531	$222	$327	$363	$479
Total nonexchange revenue refunded	5,531	222	327	363	479
Exchange revenue refunded	-	-	- -	-	
Total tax refunds and drawbacks disbursed	**$5,531**	**$222**	**$327**	**$363**	**$479**

The disbursements include interest payments of $34 million and $655 million, for the fiscal years ended September 30, 2008 and 2007, respectively (unaudited).

The disbursement totals for refunds include antidumping and countervailing duties collected that are refunded pursuant to rulings by the U.S. Department of Commerce (DOC). These duties are refunded when the DOC issues a decision in favor of the foreign industry. See Footnote 18, Other Liabilities for more information.

The total amounts of antidumping and countervailing duties vary from year to year depending on decisions from DOC. Antidumping and countervailing duty refunds (included in total refunds presented above) and associated interest refunded for the fiscal years ended September 30, 2008 and 2007, consisted of the following (in millions):

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Antidumping and Countervailing Duty Refunds	$16	$5,034
Interest	1	655
Total Antidumping and Countervailing Duty Refunds	**$17**	**$5,689**

33. Restatements

A. OHA Restatement (Unaudited)

The Department restated the FY 2007 financial statements to record accounts payable for goods delivered but not yet billed to OHA from FY 2004 through FY 2006. This error required correcting adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Custodial Activity, as follows:

A.1 – Increase intragovernmental accounts payable by $197 million;
A.2 – Decrease unexpended appropriations by $197 million;
A.3 – Increase expenses by $108 million;
A.4 – Increase appropriations used by $108 million; and
A.5 – Decrease beginning FY 2007 unexpended appropriations by $89 million.

B. FLETC Restatement (Unaudited)

The Department restated the FY 2007 financial statements to record revenues for reimbursable construction and supply expenses accrued at year-end in FY 2007 at FLETC. Additionally, because the adjustments affected intradepartmental transactions with S&T, the Department recorded an offsetting elimination entry of $10 million to the Balance Sheet, resulting in a net $1 million increase in accounts receivable and FLETC revenue, and related effects on the Statement of Budgetary Resources. The error required correcting adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Custodial Activity, as follows:

<u>FLETC:</u>
B.1 – Increase intragovernmental accounts receivable by $1 million;
B.2 – Increase revenue by $1 million;
B.3 – Decrease cumulative results of operations by $11 million;
B.4 – Increase to change in receivables from Federal sources by $11 million; and
B.5 – Decrease unfilled customer orders without advance from Federal sources by $11 million;

<u>S&T:</u>
B.6 – Decrease unexpended appropriations by $10 million; and
B.7 – Increase appropriations used by $10 million.

C. TSA Restatement (Unaudited)

Unliquidated Obligations. The Department restated the FY 2007 financial statements to deobligate unliquidated obligations at TSA. These obligations were for contracts with periods of performance that expired in FY 2007. The error required correcting adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Custodial Activity as follows:

C.1 – Decrease accounts payable with the public by $13 million;
C.2 – Decrease intragovernmental accounts payable by $1 million;
C.3 – Increase unexpended appropriations by $14 million;
C.4 – Decrease expenses by $14 million;
C.5 – Decrease appropriations used by $14 million;
C.6 – Increase recoveries of prior year obligations by $59 million;
C.7 – Decrease obligations incurred by $16 million;
C.8 – Increase unobligated balance, apportioned, by $16 million; and
C.9 – Increase unobligated balance not available by $59 million.

Capital Assets. The Department restated the FY 2007 financial statements to correct errors in capital asset balances and transactions at TSA, described below:

- The development of internal use software was being expensed in error instead of being capitalized;
- Costs related to the installation and networking of capitalized equipment were erroneously expensed in prior years;
- TSA had incorrectly been using five years instead of seven years for the useful life of certain equipment acquired in FY 2006 and FY 2007;
- TSA had not properly identified and accounted for asset impairments; and
- TSA did not use an appropriate capitalization threshold.

Correction of these errors required adjustments to each of the principal financial statements and the related footnotes, except for the Statement of Custodial Activity as follows:

C.10 – Increase property, plant, and equipment by a net value of $327 million;
C.11 – Decrease cumulative results of operations by $327 million;
C.12 – Decrease expenses by $70 million; and
C.13 – Decrease beginning FY 2007 cumulative results of operations by $257 million.

D. U.S. Coast Guard Restatement (Unaudited)

The Department restated the FY 2007 financial statements to reclassify contingent legal liabilities from a loss contingency of reasonably possible to probable related to the Oil Spill Liability Trust Fund. The error required correcting adjustments to each of the principal financial statements and related footnotes, except for the Statement of Custodial Activity as follows:

D.1 – Increase other liabilities by $89 million;
D.2 – Increase cumulative results of operations by $89 million; and
D.3 – Increase expenses by $89 million.

Additionally, this change resulted in a decrease in the total range of loss contingencies disclosed per Note 21.

E. Other Restatements (Unaudited)

The Department recorded miscellaneous restatements to correct various errors as follows:

E.1 – Decrease accounts payable with the public by $9 million;
E.2 – Decrease beginning cumulative results of operations by $9 million;
E.3 – Decrease unobligated balance brought forward by $4 million;
E.4 – Increase unpaid obligations brought forward by $4 million;
E.5 – Increase unpaid obligations, end of period, by $4 million; and
E.6 – Decrease unobligated balance, not available by $4 million.

BALANCE SHEET, in millions	Original 2007	Effects of Restatements	Restated 2007	Description Reference
ASSETS				
Intragovernmental				
Fund Balance With Treasury	$56,185	$ -	$56,185	
Investments, Net	2,778	-	2,778	
Accounts Receivable	278	1	279	B.1
Other				
Advances and Prepayments	2,887	-	2,887	
Due from Treasury	176	-	176	
Total Intragovernmental	**$62,304**	**$ 1**	**$62,305**	
Cash and Other Monetary Assets	$321	$ -	$321	
Accounts Receivable, Net	760	-	760	
Taxes, Duties, and Trade Receivables, Net	1,937	-	1,937	
Direct Loans, Net	-	-	-	
Inventory and Related Property, Net	632	-	632	
General Property, Plant, and Equipment, Net	12,275	327	12,602	C.10
Other				
Advances and Prepayments	567	-	567	
TOTAL ASSETS	**$78,796**	**$ 328**	**$79,124**	**B, C**
LIABILITIES				
Intragovernmental				
Accounts Payable	$2,066	$196	$2,262	A.1, C.1
Debt	18,153	-	18,153	
Other				
Due to the General Fund	2,085	-	2,085	
Accrued FECA Liability	355	-	355	
Other	245	-	245	
Total Intragovernmental	**$22,904**	**$196**	**$23,100**	
Accounts Payable	$3,003	$ (21)	$2,982	C.1, E.1
Federal Employee and Veteran Benefits	34,910	-	34,910	
Environmental and Disposal Liabilities	275	-	275	
Other				
Accrued Payroll	1,553	-	1,553	
Deferred Revenue and Advances from Others	2,727	-	2,727	
Unliquidated Antidumping and Countervailing Duties	514	-	514	

BALANCE SHEET, in millions	**Original 2007**	**Effects of Restatements**	**Restated 2007**	**Description Reference**
Insurance Liabilities	1,508	-	1,508	
Refunds and Drawbacks	131	-	131	
Other	1,408	89	1,497	D.1
Total Liabilities	**$68,933**	**$264**	**$69,197**	**A, C, D, E**
Net Position				
Unexpended Appropriations- Earmarked Funds	$ -	$ -	$ -	
Unexpended Appropriations- Other Funds	49,003	(193)	48,810	A.1, B.6, C.3
Cumulative Results of Operations- Earmarked Funds	(16,236)	-	(16,236)	
Cumulative Results of Operations-Other Funds	(22,904)	257	(22,647)	B.3, C.11, D.2, E.2
Total Net Position	**$9,863**	**$64**	**$9,927**	**A, B, C, D, E**
TOTAL LIABILITIES AND NET POSITION	**$78,796**	**$ 328**	**$79,124**	

STATEMENT OF NET COST, in millions	**Original 2007**	**Effects of Restatements**	**Restated 2007**	**Description Reference**
Directorates and Other Components				
U.S. Customs and Border Protection				
Gross Cost	$8,198	$ -	$8,198	
Less Earned Revenue	(157)	-	(157)	
Net Cost	8,041	-	8,041	
U.S. Coast Guard				
Gross Cost	10,564	89	10,653	D.3
Less Earned Revenue	(492)	-	(492)	
Net Cost	10,072	89	10,161	
U.S. Citizenship and Immigration Services				
Gross Cost	1,731	-	1,731	
Less Earned Revenue	(1,659)	-	(1,659)	
Net Cost	72	-	72	
Federal Emergency Management Agency				
Gross Cost	14,272	-	14,272	
Less Earned Revenue	(2,842)	-	(2,842)	
Net Cost	11,430	-	11,430	
Federal Law Enforcement Training Center				
Gross Cost	402	-	402	
Less Earned Revenue	(40)	(1)	(41)	B.2
Net Cost	362	(1)	361	
National Protection and Preparedness Directorate				
Gross Cost	855	-	855	
Less Earned Revenue	-	-	-	
Net Cost	855	-	855	
U.S. Immigration and Customs Enforcement				
Gross Cost	4,891	-	4,891	
Less Earned Revenue	(900)	-	(900)	
Net Cost	3,991	-	3,991	

STATEMENT OF NET COST, in millions	**Original 2007**	**Effects of Restatements**	**Restated 2007**	**Description Reference**
Office of Health Affairs				
Gross Cost	5	108	113	A.3
Less Earned Revenue	-	-	-	
Net Cost	5	108	113	
Departmental Operations and Other				
Gross Cost	1,204	-	1,204	
Less Earned Revenue	(3)	-	(3)	
Net Cost	1,201	-	1,201	
U.S. Secret Service				
Gross Cost	1,689	-	1,689	
Less Earned Revenue	(16)	-	(16)	
Net Cost	1,673	-	1,673	
Science and Technology Directorate				
Gross Cost	987	-	987	
Less Earned Revenue	(14)	-	(14)	
Net Cost	973	-	973	
Transportation Security Administration				
Gross Cost	6,439	(83)	6,356	C.4, C.12
Less Earned Revenue	(2,299)	-	(2,299)	
Net Cost	4,140	(83)	4,057	
NET COST OF OPERATIONS	**$42,815**	**$113**	**$42,928**	**A, B, C, D**

STATEMENT OF CHANGES IN NET POSITION, in millions	**Original 2007**	**Effects of Restatements**	**Restated 2007**	**Description Reference**
Cumulative Results of Operations				
Beginning Balances	$(39,563)	$ -	$(39,563)	
Adjustments:				
Corrections of Errors	-	266	266	C.13, E.2
Beginning balance, as adjusted	**$(39,563)**	**$ 266**	**$(39,297)**	
Budgetary Financing Sources:				
Appropriations Used	$39,074	$104	$39,178	A.4, B.7, C.5
Non-Exchange Revenue	3,609	-	3,609	
Donations and Forfeitures of Cash and Cash Equivalents	2	-	2	
Transfers in/out without Reimbursement	(125)	-	(125)	
Other	(174)	-	(174)	
Other Financing Sources (Non-Exchange):				
Donations and Forfeitures of Property	4	-	4	
Transfers in/out reimbursement	9	-	9	
Imputed Financing	839	-	839	
Total Financing Sources	43,238	104	43,342	
Net Cost of Operations	(42,815)	(113)	(42,928)	
Net Change	**423**	**(9)**	**414**	**A, B, C, E**
Cumulative Results of Operations	**$(39,140)**	**$ 257**	**$(38,883)**	
Unexpended Appropriations:				
Beginning Balance	$48,853	$ -	$48,853	
Adjustments:				
Corrections of errors	-	(89)	(89)	A.5
Beginning Balance, as adjusted	**$48,853**	**$(89)**	**$48,764**	
Budgetary Financing Sources:				
Appropriations Received	$39,520	$ -	$39,520	
Appropriations transferred in/out	295	-	295	
Other Adjustments	(591)	-	(591)	
Appropriations Used	(39,074)	(104)	(39,178)	A.4, B.7, C.5
Total Budgetary Financing Sources	150	(104)	46	
Total Unexpended Appropriations	**49,003**	**(193)**	**48,810**	**A, B, C**
NET POSITION	**$9,863**	**$64**	**$9,927**	

STATEMENT OF BUDGETARY RESOURCES, in millions	**Original 2007**		**Effects of Restatements**		**Restated 2007**		
	Budgetary	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Budgetary**	**Non-Budgetary Credit Reform Financing Accounts**	**Description Reference**
BUDGETARY RESOURCES							
Unobligated Balance, brought forward October 1	$17,313	$-	$(4)	$ -	$17,309	$ -	E.3
Recoveries of Prior Year Unpaid Obligations	4,938	-	59	-	4,997	-	C.6
Budget Authority:							
Appropriations	46,491	-	-	-	46,491	-	
Borrowing Authority	-	-	-	-	-	-	
Spending Authority from Offsetting Collections:							
Earned:							
Collected	9,963	336	-	-	9,963	336	
Change in Receivable from Federal Sources	(5)	-	12	-	7	-	B.4
Change in Unfilled Customer Orders:							
Advance Received	78	-	-	-	78	-	
Without Advance From Federal Sources	707	(122)	(11)	-	696	(122)	B.5
Previously unavailable	-	-	-	-	-	-	
Expenditure transfers from trust funds	47	-	-	-	47	-	
Subtotal	57,281	214	- 1	-	57,282	214	
Non-expenditure transfers, net; anticipated and actual	787	-	-	-	787	-	
Temporarily Not Available Pursuant to Public Law	-	-		-	-	-	
Permanently Not Available	(671)	(70)	-	-	(671)	(70)	
TOTAL BUDGETARY RESOURCES	**$79,648**	**$144**	**$56**	**$ -**	**$79,704**	**$144**	**B, C, E**

STATEMENT OF BUDGETARY RESOURCES, in millions	Original 2007 Budgetary	Original 2007 Non-Budgetary Credit Reform Financing Accounts	Effects of Restatements Budgetary	Effects of Restatements Non-Budgetary Credit Reform Financing Accounts	Restated 2007 Budgetary	Restated 2007 Non-Budgetary Credit Reform Financing Accounts	Description Reference
STATUS OF BUDGETARY RESOURCES							
Obligations Incurred:							
Direct	$56,669	$13	$ (16)	$ -	$56,653	$13	C.7
Reimbursable	5,320	-	-	-	5,320	-	
Subtotal	**61,989**	**13**	**(16)**	**-**	**61,973**	**13**	
Unobligated Balance:							
Apportioned	9,141	12	16	-	9,157	12	C.8
Exempt from Apportionment	97	-	-	-	97	-	
Subtotal	**9,238**	**12**	**16**	**-**	9,254	12	
Unobligated Balance Not Available	8,421	119	56	-	8,477	119	C.9, E.6
TOTAL STATUS OF BUDGETARY RESOURCES	**$79,648**	**$144**	**$56**	**$ -**	**$79,704**	**$144**	**C, E**

STATEMENT OF BUDGETARY RESOURCES, in millions	Original 2007 Budgetary	Original 2007 Non-Budgetary Credit Reform Financing Accounts	Effects of Restatements Budgetary	Effects of Restatements Non-Budgetary Credit Reform Financing Accounts	Restated 2007 Budgetary	Restated 2007 Non-Budgetary Credit Reform Financing Accounts	Description Reference
CHANGE IN OBLIGATED BALANCE							
Obligated Balance, Net							
Unpaid obligations brought forward, October 1	$43,036	$ 642	$4	$ -	$43,040	$642	E.4
Less: Uncollected customer payments from Federal Sources, brought forward, October 1	(2,069)	(482)	-	-	(2,069)	(482)	
Total unpaid obligated balance, net	40,967	160	4	-	40,971	160	
Obligations incurred, net	61,989	13	(16)	-	61,973	13	C.7
Less: Gross Outlays	(56,293)	(175)	-	-	(56,293)	(175)	
Obligated balance transferred, net							
Actual transfers, unpaid obligations	(18)	-	-	-	(18)	-	
Total unpaid obligated balance transferred, net	(18)	-	-	-	(18)	-	
Recoveries of Prior Year Unpaid Obligations, Actual	(4,938)	-	(59)	-	(4,997)	-	C.6
Change in uncollected customer payments from Federal Sources	(702)	121	-	-	(702)	121	
Obligated balance, net end of period							
Unpaid obligations	43,775	480	(71)	-	43,704	480	C.6, C.7, E.5
Less: Uncollected customer payments from Federal Sources	(2,770)	(361)	-	-	(2,770)	(361)	
Total, unpaid obligated balance, net end of period	41,005	119	(71)	-	40,934	119	C, E
Net Outlays							
Gross Outlays	56,293	175	-	-	56,293	175	
Less: Offsetting Collections	(10,090)	(336)	-	-	(10,090)	(336)	
Less: Distributed Offsetting Receipts	(4,952)	-	-	-	(4,952)	-	
NET OUTLAYS	**$41,251**	**$(161)**	**$ -**	**$ -**	**$41,251**	**$(161)**	

34. Reconciliation of Net Cost of Operations (Proprietary) to Budget

The Reconciliation of Net Cost of Operations to Budget reconciles the Department's *Resources Used to Finance Activities* (first section), which consists of the budgetary basis of accounting Net Obligations plus the proprietary basis of accounting Other Resources, to the proprietary basis of accounting Net Cost of Operations. The second section, *Resources Used to Finance Items Not Part of the Net Cost of Operations*, reverses out items included in the first section that are not included in Net Cost of Operations. The third section, *Components of Net Cost of Operations that Will Not Require or Generate Resources in the Current Period*, adds items included in the Net Cost of Operations that are not included in the first section.

The third section's subsection, *Components Requiring or Generating Resources in Future Periods*, includes costs reported in the current period that are included in the Liabilities Not Covered by Budgetary Resources reported in Note 14. This subsection does not include costs reported in prior fiscal years that are also included in Liabilities Not Covered by Budgetary Resources.

The reconciliations of net cost of operations to budget for FY 2008 and FY 2007 are as follows:

	2008 (Unaudited)	2007 (Unaudited) (Restated)
Resources Used to Finance Activities		
Budgetary Resources Obligated		
Obligations Incurred (Note 25)	$65,489	$61,986
Less: Spending Authority from Offsetting Collections and Recoveries	(13,172)	(16,002)
Obligations Net of Offsetting Collections and Recoveries	52,317	45,984
Less: Offsetting Receipts	(6,048)	(4,952)
Net Obligations	46,269	41,032
Other Resources		
Donations and Forfeiture of Property	14	4
Transfers in (out) Without Reimbursement	18	9
Imputed Financing from Costs Absorbed by Others	738	839
Other	(63)	-
Net Other Resources Used to Finance Activities	707	852
Total Resources Used to Finance Activities	**$46,976**	**$41,884**

Resources Used to Finance Items Not Part of the Net Cost of Operations		
Change in Budgetary Resources Obligated for Goods, Services and Benefits Ordered but not yet Provided	$4,858	$344
Resources that Fund Expenses Recognized in Prior Periods	(347)	(1,500)
Budgetary Offsetting Collections and Receipts that do not Affect Net Cost of Operations:		
Credit program Collections that Increase Liabilities for Loan Guarantees or Allowances for Subsidy	172	336
Other	(2,862)	(2,355)
Resources that Finance the Acquisition of Assets	4,035	2,926
Other Resources or Adjustments to Net Obligated Resources that do not Affect Net Cost of Operations	1,008	1,733
Total Resources Used to Finance Items Not Part of the Net Cost of Operations	6,864	1,484
TOTAL RESOURCES USED TO FINANCE THE NET COST OF OPERATIONS	**$40,112**	**$40,400**
Components of the Net Cost of Operations that will not Require or Generate Resources in the Current Period:		
Components Requiring or Generating Resources in Future Periods		
Increase in Annual Leave Liability	$105	$85
Increase in Environmental and Disposal Liability	20	34
Increase in Exchange Revenue Receivable from the Public	-	(1)
Other		
Increase in Insurance Liabilities	92	3
Increase in Actuarial Pension Liability	729	2,200
Increase in U.S. Coast Guard Military Post Employment PCS Benefits	-	6
Increase in Actuarial Health Insurance Liability	447	265
Other	4,449	(1,679)
Total Components of Net Cost of Operations that will Require or Generate Resources in Future Periods	5,842	913
Components not Requiring or Generating Resources		
Depreciation and Amortization	1,375	1,153
Revaluation of Assets or Liabilities	167	17
Other	662	445
Total Components of Net Cost of Operations that will not Require or Generate Resources	2,204	1,615
Total Components of Net Cost of Operations That Will Not Require or Generate Resources in the Current Period	**8,046**	**2,528**
NET COST OF OPERATIONS	**$48,158**	**$42,928**

35. Explanation for the Adjustment to the FY 2008 Beginning Balances

During FY 2007, the Department was a party in allocation transfers with other Federal agencies as both a transferring (parent) entity and/or a receiving (child) entity. During FY 2007, the Department, as the parent, reported funds related to activities for the Biodefense Countermeasures Fund to the U.S. Department of Health and Human Services (HHS) in accordance with OMB Circular A-136 requirements. OMB granted DHS an exception over this fund as a parent for FY 2008 and future periods, whereby HHS will report all balances. Therefore, the balances from this fund will no longer be reported in the DHS financial statements and related footnotes beginning with FY 2008. The exemption granted by OMB does not result in a restatement or reclassification of prior year amounts.

Consequently, DHS Current Year Beginning Balances and Prior Year Ending Balances differ. The Statement of Budgetary Resources has differences for the current year and prior year balances for Unobligated Balances Brought Forward of $517 million and Unpaid Obligations of $951 million. Further, the Statement of Changes in Net Position shows adjustments to the current year beginning balance for Unexpended Appropriations of $1,468 million.

Required Supplementary Information (Unaudited)

1. Stewardship PP&E

Heritage Assets

The U.S. Coast Guard, CBP, and FEMA maintain heritage assets, located in the United States, including the Commonwealth of Puerto Rico. Heritage assets are PP&E that have historical or national significance; cultural, educational, or artistic importance; or significant architectural characteristics. Heritage assets are generally expected to be preserved indefinitely. Multi-use heritage assets have more than one purpose such as an operational purpose and historical purpose.

The following table summarizes activity related to heritage assets for the fiscal years ended September 30 (in number of units).

2008 (Unaudited)	USCG	CBP	FEMA	Total
Beginning Balance	20,549	4	1	20,554
Additions	203	-	-	203
Withdrawals	(289)	-	-	(289)
Ending Balance	**20,463**	**4**	**1**	**20,468**

2007 (Unaudited) (Restated)	USCG	CBP	FEMA	Total
Beginning Balance	20,425	4	1	20,430
Additions	278	-	-	278
Withdrawals	(154)	-	-	(154)
Ending Balance	**20,549**	**4**	**1**	**20,554**

The U.S. Coast Guard possesses artifacts that can be divided into six general areas: ship's equipment, lighthouse and other aids-to-navigation/communication items, personal use items, ordnance, artwork, and display models. Historical artifacts are also gifted to the U.S. Coast Guard. Withdrawals are made when items have deteriorated through inappropriate display, damage due to moving and transportation, or environmental degradation. Withdrawals are also made when the U.S. Coast Guard curatorial staff, in conjunction with the U.S. Coast Guard Historian, determines that an artifact does not meet the needs of the collection or is duplicated.

- Ship's equipment is generally acquired when the ship is decommissioned and includes small items such as sextants, ship's clocks, wall plaques, steering wheels, bells, binnacles, engine order telegraphs, ship's name boards, silver service items, china, and other equipment that is either unique or provides a means to education on U.S. Coast Guard history. Conditions will vary based upon use and age.

- Aids-to-navigation/communication items include fog and buoy bells, lanterns, lamp changing apparatus, lighthouse lenses, flags, trophies, and plaques. Buoy equipment is usually acquired when new technology renders the equipment obsolete. Classical lighthouse lenses can vary in condition. The condition is normally dependent on how long the item has been out of service. The lenses go to local museums or U.S. Coast Guard bases as display items.
- Personal use items are generally donated by retired U.S. Coast Guard members and include clothing as well as insignia and accessories. Most clothing is in fair to good condition, particularly full dress items.
- Ordnance includes cannons, rifles, pistols, lyle guns and associated accessories.
- Artwork consists of a mix of modern art depicting both historical and modern U.S. Coast Guard activities and the U.S. Coast Guard's collection of World War II combat art.
- Display models are mostly of U.S. Coast Guard vessels and aircraft. These are often builders' models. Display models are generally in very good condition. Builders' models are acquired by the U.S. Coast Guard as part of the contracts with the ship or aircraft builders. The withdrawal of display models normally results from excessive wear.

The U.S. Coast Guard also has non-collection type heritage assets, such as sunken vessels and aircraft, under the property clause of the U.S. Constitution, Articles 95 and 96 of the International Law of the Sea Convention, and the sovereign immunity provisions of Admiralty law. Despite the passage of time or the physical condition of these assets, they remain government-owned until the Congress of the United States formally declares them abandoned. The U.S. Coast Guard desires to retain custody of these assets to safeguard the remains of crew members lost at sea, to prevent the unauthorized handling of explosives or ordnance which may be aboard, and to preserve culturally valuable relics of the U.S. Coast Guard's long and rich tradition of service to our Nation in harm's way.

The U.S. Coast Guard does not acquire or retain heritage buildings and structures without an operational use. Most real property, even if designated as historical, is acquired for operational use and is transferred to other government agencies or public entities when no longer required for operations. Of the U.S. Coast Guard buildings and structures designated as heritage, including memorials, recreational areas, and other historical areas, over two-thirds are multi-use heritage. The remaining assets are historical lighthouses, which are no longer in use and awaiting disposal; their related assets; and a gravesite.

CBP also has four multi-use heritage assets located in Puerto Rico, and FEMA has one multi-use heritage asset that is used by the U.S. Fire Administration for training in Emmitsburg, Maryland. All multi-use heritage assets are reflected on the Balance Sheet and related footnotes. Deferred maintenance information for heritage assets and general PP&E is presented in the required supplementary information.

2. Deferred Maintenance

The Department Components use condition assessment as the method for determining the deferred maintenance for each class of asset. The procedure includes reviewing equipment, building, and other structure logistic reports. Component logistic personnel identify maintenance not performed as scheduled and establish future performance dates. Logistic personnel use a condition assessment survey to determine the status of referenced assets according to the range of conditions shown below:

Good. Facility/equipment condition meets established maintenance standards, operates efficiently, and has a normal life expectancy. Scheduled maintenance should be sufficient to maintain the current condition. There is no deferred maintenance on buildings or equipment in good condition.

Fair. Facility/equipment condition meets minimum standards but requires additional maintenance or repair to prevent further deterioration, increase operating efficiency, and to achieve normal life expectancy.

Poor. Facility/equipment does not meet most maintenance standards and requires frequent repairs to prevent accelerated deterioration and provide a minimal level of operating function. In some cases, this includes condemned or failed facilities. Based on periodic condition assessments, an indicator of condition is the percent of facilities and item of equipment in each of the good, fair, or poor categories.

Deferred maintenance as of September 30, 2008, was estimated to range from $1,062 million to $1,296 million on general property, plant, and equipment and Heritage Assets with a range of poor to good condition. In FY 2007, the Department reported estimated deferred maintenance ranging from $777 million to $1,064 million on general property, plant, and equipment and Heritage Assets with a range of poor to good condition. These amounts represent maintenance on vehicles, vessels, and buildings and structures owned by the Department that was not performed when it should have been, or was scheduled to be and was delayed for a future period.

A summary of deferred maintenance, by asset class, at September 30, 2008, is presented below (in millions):

	Low estimate	**High estimate**	**Asset Condition**
Building & Structures	$ 788	$ 948	Good to Poor
Equipment (vehicles and vessels)	270	341	Good to Fair
Heritage assets	4	7	Good to Fair
Total	**$ 1,062**	**$ 1,296**	

3. Statement of Budgetary Resources

Schedule of FY 2008 Budgetary Resources by Responsibility Segments (in millions) (page 1 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
BUDGETARY RESOURCES													
Unobligated balance, brought forward, Oct 1	$2,896	$1,666	$844	$8,482	$81	$498	$925	$433	$377	$82	$296	$765	**$17,345**
Recoveries of Prior Year Obligations	485	117	51	2,757	20	191	2	37	15	-	34	115	**3,824**
Budget Authority:													
Appropriations	11,973	9,032	2,555	18,720	289	4,993	116	1,456	1,177	1,612	829	4,901	**57,653**
Borrowing Authority	-	-	-	-	-	-	-	-	-	-	-	-	-
Spending Authority from Offsetting Collections:													
Earned:													
Collected	1,612	525	33	3,670	179	1,123	28	445	12	28	33	1,934	**9,622**
Change in Receivable from Federal Sources	(6)	-	(3)	(23)	(8)	7	4	19	-	(7)	(1)	(1)	**(19)**
Change in Unfilled Customer Orders:													
Advance Received	-	(2)	1	49	-	1	-	42	(1)	(4)	1	(3)	**84**
Without Advance From Federal Sources	(34)	(21)	6	(281)	(23)	(21)	1	-	2	1	19	(36)	**(387)**
Anticipated for Rest of Year, without advances	-	-	-	-	-	-	-	-	-	-	-	-	-
Previously Unavailable	-	-	-	-	-	-	-	-	-	-	-	-	-
Expenditure transfers from trust funds	3	45	-	-	-	-	-	-	-	-	-	-	**48**
Subtotal	13,548	9,579	2,592	22,135	437	6,103	149	1,962	1,190	1,630	881	6,795	**67,001**
Non-expenditure transfers, net; anticipated and actual	334	356	(8)	(24)	9	29	(915)	8	(6)	18	-	(11)	**(210)**
Temporarily Not Available Pursuant to Public Law	-	(14)	-	-	-	-	-	-	-	-	-	-	**(14)**
Permanently Not Available	(87)	(325)	(11)	(584)	(6)	(22)	-	(42)	(15)	(32)	-	(10)	**(1,134)**
TOTAL BUDGETARY RESOURCES	**$17,176**	**$11,379**	**$3,468**	**$32,766**	**$541**	**$6,799**	**$161**	**$2,398**	**$1,561**	**$1,698**	**$1,211**	**$7,654**	**$86,812**
STATUS OF BUDGETARY RESOURCES													
Obligations Incurred:													
Direct	12,939	9,052	2,470	14,757	285	4,909	118	1,573	1,258	1,616	989	6,859	**56,825**
Reimbursable	1,764	535	29	4,436	151	1,119	33	520	5	19	48	5	**8,664**
Subtotal	14,703	9,587	2,499	19,193	436	6,028	151	2,093	1,263	1,635	1,037	6,864	**65,489**
Unobligated Balance:													
Apportioned	8	835	536	4,193	83	357	10	255	128	15	166	642	**7,228**
Exempt from Apportionment	-	89	-	2	(1)	-	-	1	-	-	-	-	**91**
Subtotal	8	924	536	4,195	82	357	10	256	128	15	166	642	**7,319**
Unobligated Balance Not Available	2,465	868	433	9,378	23	414	-	49	170	48	8	148	**14,004**
TOTAL STATUS OF BUDGETARY RESOURCES	**$17,176**	**$11,379**	**$3,468**	**$32,766**	**$541**	**$6,799**	**$161**	**$2,398**	**$1,561**	**$1,698**	**$1,211**	**$7,654**	**$86,812**

Schedule of FY 2008 Budgetary Resources by Responsibility Segments (in millions) (page 2 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
CHANGE IN OBLIGATED BALANCES													
Obligated Balance, Net													
Unpaid obligations brought forward, Oct 1	$4,069	$3,812	$700	$25,285	$221	$2,176	$914	$1,297	$697	$333	$1,097	$2,632	**$43,233**
Uncollected customer payments from federal sources, brought forward, Oct 1	(321)	(214)	(13)	(1,661)	(134)	(431)	-	(253)	(2)	(19)	(34)	(49)	**(3,131)**
Total unpaid obligated balance, net	3,748	3,598	687	23,624	87	1,745	914	1,044	695	314	1,063	2,583	**40,102**
Obligations incurred, net	14,703	9,587	2,499	19,193	436	6,028	151	2,093	1,263	1,635	1,037	6,864	**65,489**
Gross Outlays	(12,833)	(9,394)	(2,096)	(14,900)	(468)	(5,607)	(306)	(1,741)	(965)	(1,622)	(993)	(6,434)	**(57,359)**
Obligated balance transferred, net	-	-	-	(25)	-	-	-	-	-	-	-	-	**(25)**
Recoveries of Prior Year Unpaid Obligations	(485)	(117)	(51)	(2,757)	(20)	(191)	(2)	(37)	(15)	-	(34)	(115)	**(3,824)**
Change in uncollected customer payments from Federal Sources	41	21	(2)	304	30	15	(4)	(19)	(2)	5	(18)	34	**405**
Obligated balance, net end of Period													
Unpaid Obligations	5,454	3,888	1,053	26,796	169	2,406	758	1,612	979	346	1,107	2,946	**47,514**
Uncollected customer payments from Federal Sources	(280)	(193)	(16)	(1,357)	(104)	(416)	(5)	(272)	(3)	(14)	(52)	(14)	**(2,726)**
Total, unpaid obligated balance, net, end of period	5,174	3,695	1,037	25,439	65	1,990	753	1,340	976	332	1,055	2,932	**44,788**
NET OUTLAYS													
Net Outlays													
Gross Outlays	12,833	9,394	2,096	14,900	468	5,607	306	1,741	965	1,622	993	6,434	**57,359**
Offsetting collections	(1,614)	(568)	(33)	(3,719)	(180)	(1,125)	(28)	(487)	(11)	(24)	(34)	(1,931)	**(9,754)**
Distributed offsetting receipts	(2,797)	(5)	(2,625)	37	-	(153)	-	(2)	-	(1)	-	(502)	**(6,048)**
Net Outlays	**$8,422**	**$8,821**	**$(562)**	**$11,218**	**$288**	**$4,329**	**$278**	**$1,252**	**$954**	**$1,597**	**$959**	**$4,001**	**$41,557**

Schedule of FY 2007 Budgetary Resources by Responsibility Segments (in millions) (page 1 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
BUDGETARY RESOURCES													
Unobligated balance, brought forward, Oct 1	$2,297	$1,881	$419	$9,166	$88	$654	$1,468	$218	$279	$56	$408	$375	**$17,309**
Recoveries of Prior Year Obligations	199	-	59	3,022	14	215	915	42	47	14	70	400	**4,997**
Budget Authority:													
Appropriations	11,191	8,551	2,323	10,700	275	4,209	8	1,636	965	1,494	978	4,161	**46,491**
Spending Authority from Offsetting Collections:													
Earned:													
Collected	1,514	575	35	3,803	137	1,141	-	400	-	23	35	2,636	**10,299**
Change in Receivable from Federal Sources	(34)	(11)	2	9	19	(8)	-	25	-	2	2	1	**7**
Change in Unfilled Customer Orders:													
Advance Received	(3)	38	-	42	-	(1)	-	-	2	(6)	1	5	**78**
Without Advance From Federal Sources	(20)	(8)	(14)	669	(39)	(45)	1	52	1	(4)	(2)	(17)	**574**
Previously Unavailable	-	-	-	(1)	-	-	-	-	-	-	-	1	**-**
Expenditure transfers from trust funds	3	45	-	-	-	-	-	-	-	-	-	(1)	**47**
Subtotal	12,651	9,190	2,346	15,222	392	5,296	9	2,113	968	1,509	1,014	6,786	**57,496**
Non-expenditure transfers, net; anticipated and actual	373	323	-	67	-	(8)	17	6	(4)	8	-	5	**787**
Temporarily Not Available Pursuant to Public Law	-	-	-	-	-	-	-	-	-	-	-	-	**-**
Permanently Not Available	(102)	(222)	(12)	(135)	(3)	(28)	-	(18)	(5)	(21)	(128)	(67)	**(741)**
TOTAL BUDGETARY RESOURCES	**$15,418**	**$11,172**	**$2,812**	**$27,342**	**$491**	**$6,129**	**$2,409**	**$2,361**	**$1,285**	**$1,566**	**$1,364**	**$7,499**	**$79,848**
STATUS OF BUDGETARY RESOURCES													
Obligations Incurred:													
Direct	$11,036	$8,956	$1,939	$17,308	$288	$4,560	$966	$1,467	$908	$1,468	$1,045	$6,725	**$56,666**
Reimbursable	1,487	551	28	1,552	123	1,066	-	462	1	16	24	10	**5,320**
Subtotal	12,523	9,507	1,967	18,860	411	5,626	966	1,929	909	1,484	1,069	6,735	**61,986**
Unobligated Balance:													
Apportioned	17	923	233	5,999	64	300	528	336	170	47	291	261	**9,169**
Exempt from Apportionment	-	92	-	5	-	-	-	-	-	-	-	-	**97**
Subtotal	17	1,015	233	6,004	64	300	528	336	170	47	291	261	**9,266**
Unobligated Balance Not Available	2,878	650	612	2,478	16	203	915	96	206	35	4	503	**8,596**
TOTAL STATUS OF BUDGETARY RESOURCES	**$15,418**	**$11,172**	**$2,812**	**$27,342**	**$491**	**$6,129**	**$2,409**	**$2,361**	**$1,285**	**$1,566**	**$1,364**	**$7,499**	**$79,848**

Schedule of FY 2007 Budgetary Resources by Responsibility Segments (in millions) (page 2 of 2)

	CBP	USCG	USCIS	FEMA	FLETC	ICE	OHA	DeptOps	NPPD	USSS	S&T	TSA	TOTAL
CHANGE IN OBLIGATED BALANCES													
Obligated Balance, Net													
Unpaid obligations brought forward, Oct 1	$3,067	$3,144	$640	$27,673	$267	$1,649	$1,802	$758	$773	$307	$1,256	$2,346	**$43,682**
Uncollected customer payments from federal sources, brought forward, Oct 1	(375)	(233)	(25)	(981)	(153)	(484)	-	(175)	(1)	(21)	(34)	(69)	**(2,551)**
Total unpaid obligated balance, net	2,692	2,911	615	26,692	114	1,165	1,802	583	772	286	1,222	2,277	**41,131**
Obligations incurred, net	12,523	9,507	1,967	18,860	411	5,626	966	1,929	909	1,484	1,069	6,735	**61,986**
Gross Outlays	(11,356)	(8,839)	(1,814)	(18,208)	(443)	(4,889)	(3)	(1,348)	(926)	(1,444)	(1,153)	(6,045)	**(56,468)**
Obligated balance transferred, net	34	-	(34)	(18)	-	-	15	2	(12)	-	(5)	-	**(18)**
Recoveries of Prior Year Unpaid Obligations	(199)	-	(59)	(3,022)	(14)	(215)	(915)	(42)	(47)	(14)	(70)	(400)	**(4,997)**
Change in uncollected customer payments from Federal Sources	55	20	12	(679)	19	54	-	(81)	(1)	2	-	18	**(581)**
Obligated balance, net end of Period													
Unpaid Obligations	4,070	3,813	700	25,285	221	2,172	1,865	1,296	697	333	1,097	2,635	**44,184**
Uncollected customer payments from Federal Sources	(321)	(214)	(13)	(1,660)	(134)	(431)	-	(253)	(2)	(19)	(34)	(50)	**(3,131)**
Total, unpaid obligated balance, net, end of period	3,749	3,599	687	23,625	87	1,741	1,865	1,043	695	314	1,063	2,585	**41,053**
NET OUTLAYS													
Net Outlays													
Gross Outlays	11,356	8,839	1,814	18,208	443	4,889	3	1,348	926	1,444	1,153	6,045	**56,468**
Offsetting collections	(1,515)	(657)	(35)	(3,846)	(135)	(1,140)	-	(400)	(2)	(18)	(36)	(2,642)	**(10,426)**
Distributed offsetting receipts	(2,361)	(23)	(2,080)	(61)	(1)	(155)	(1)	2	-	-	1	(273)	**(4,952)**
Net Outlays	**$7,480**	**$8,159**	**$(301)**	**$14,301**	**$307**	**$3,594**	**$2**	**$950**	**$924**	**$1,426**	**$1,118**	**$3,130**	**$41,090**

4. Statement of Custodial Activity

Substantially all duty, tax, and fee revenues collected by CBP are remitted to various General Fund accounts maintained by Treasury and the U.S. Department of Agriculture. Treasury further distributes these revenues to other Federal agencies in accordance with various laws and regulations. CBP transfers the remaining revenue (generally less than two percent of revenues collected) directly to other Federal agencies, the Governments of Puerto Rico and the U.S. Virgin Islands, or retains funds as authorized by law or regulations. Refunds of revenues collected from import/export activities are recorded in separate accounts established for this purpose and are funded through permanent indefinite appropriations. These activities reflect the non-entity, or custodial, responsibilities that CBP, as an agency of the Federal Government, has been authorized by law to enforce.

CBP reviews selected documents to ensure all duties, taxes, and fees owed to the Federal Government are paid and all regulations are followed. If CBP believes duties, taxes, fees, fines, or penalties are due in addition to estimated amounts previously paid by the importer/violator, the importer/violator is notified of the additional amount due. CBP regulations allow the importer/violator to file a protest on the additional amount due for review by the Port Director. A protest allows the importer/violator the opportunity to submit additional documentation supporting their claim of a lower amount due or to cancel the additional amount due in its entirety. Work in progress will continue until all protest options have expired or an agreement is reached. During this protest period, CBP does not have a legal right to the importer/violator's assets, and consequently CBP recognizes accounts receivable only when the protest period has expired or an agreement is reached. For FY 2008 and FY 2007, CBP had legal right to collect \$2.1 billion and \$1.9 billion of receivables, respectively. There was an additional \$2 billion and \$2.7 billion representing records still in the protest phase for FY 2008 and FY 2007, respectively. CBP recognized as write-offs \$310 million and \$183 million respectively, of assessments that the Department has statutory authority to collect at September 30, 2008 and 2007, but has no future collection potential. Most of this amount represents fines, penalties, and interest.

5. Risk Assumed Information

The Department has performed an analysis of the contingencies associated with the unearned premium reserve for the NFIP. The underlying calculation estimates the amount of subsidy in the total rates, removes the expense load, and applies the results to the unearned premium reserve. The range is designed to straddle the resulting estimate. That analysis shows unearned premium reserve is less than the estimated present value of unpaid expected losses by \$500 to \$600 million.

Actual flood losses are highly variable from year to year. For the majority of years, this unearned premium reserve is adequate to pay the losses and expenses associated with this unearned premium. In those years with catastrophic flooding, the reserve will prove inadequate, and the average across all years will be inadequate because of the subsidies in premium levels.

Required Supplementary Stewardship Information (Unaudited)

Stewardship Investments

Stewardship investments are substantial investments made by the Federal Government for the benefit of the Nation. When incurred, stewardship investments are treated as expenses in calculating net cost, but they are separately reported as Required Supplementary Stewardship Information (RSSI) to highlight the extent of investments that are made for long-term benefit. The Department's expenditures (including carryover funds expended in FY 2008) in Human Capital and Research and Development are shown below:

Summary of Stewardship Investments (in millions)

	FY 2008	FY 2007	FY 2006	FY 2005	FY 2004
Research and Development	$880	$1,115	$1,144	$975	$364
Human Capital	78	89	29	21	8
Non-Federal Physical Property	204	394	(118)	394	496
Total	$1,162	$1,598	$1,055	$1,390	$868

1. Investments in Research and Development

Investments in Research and Development represent expenses incurred to support the search for new or refined knowledge and ideas for the application or use of such knowledge for the development of new or improved products and processes with the expectation of maintaining or increasing national productive capacity or yielding other future benefits. TSA, the U.S. Coast Guard, and S&T have made significant investments in Research and Development.

<u>TSA</u>

TSA funds applied research projects and grants to develop advance security technology equipment and systems. Projects include partnerships with George Mason University, the Regional Maritime Security Coalition, and the Federal Aviation Administration. These applied research projects include human factors research intended to enhance screening officers' capabilities, improve person-machine performance, and increase human system effectiveness, including ongoing certification testing of explosive detection systems (EDS) and explosives trace detection (ETD) technology; and infrastructure protection research related to using biometrics for passenger access controls and tracking.

Operation Safe Commerce is a pilot program that brings together private business, ports, and local, State, and Federal representatives to analyze current security procedures for cargo entering the country. The new technologies look at improving security during the process of stuffing and deconsolidating containers, physically securing and monitoring containers as they are transported through the supply chain, and exchanging timely and reliable communication.

U.S. Coast Guard

The U.S. Coast Guard Research & Development Program invests in the application of research and development projects. Following are some of the major developmental projects that are ongoing:

- Determine the most effective Unmanned Aerial System (UAS) to operate off the National Security Cutter (NSC). Provide U.S. Coast Guard leadership with the information, traceable to NSC mission needs, to support a UAS major acquisition program. Report on the capability that will provide the most value for the lowest risk to meet NSC mission needs;
- Develop a means to certify a shipboard system to insure aquatic nuisance species (ANS) have been eradicated before entering U.S. waters;
- Further develop the at-sea biometrics system that can leverage a unique, identifiable human characteristic to identify individuals encountered at sea. Partner with and leverage the databases of other government agencies; and
- Improve port security by clearly identifying/prioritizing gaps and providing support for Countermeasures Strategy (CS) development to the U.S. Coast Guard through identification of critical needs across both prevention and response phases of operations relative to threat vectors from explosives in the (surface) maritime environment.

Significant Accomplishments in Development:

- Testing small Unmanned Aerial Vehicles for greater surveillance capabilities: Developed a Modeling and Simulation (M&S) capability that can be used during a field exercise to produce a visualization tool for post test event analysis and future event planning;
- Developing and evaluating at-sea biometrics system prototype for migrant identification: Developed proof-of-concept portable biometric collections system that could be used in a maritime environment. Implemented and operated this stand-alone biometric system and delivered standard operating procedures, training package, and equipment to the U.S. Coast Guard operational entity;
- Developed specific tools that model the survivability of distressed mariners in a variety of conditions and that can be incorporated into search and rescue (SAR) planning software to provide clear and understandable operational SAR guidance and decision support tools for decision makers; and
- Developed a Sensor Visualization and Analysis Tool to visualize and assess a variety of surveillance/search concepts of operations and provide guidance on setting up sensors for the best coverage in key tactical situations.

The following major new applications developments are ongoing:

- Develop and evaluate the most promising capabilities and techniques for recovering heavy viscous oil on the ocean floor; integrate those capabilities and techniques with heavy oil detection systems;
- Conduct market research to identify and evaluate technologies that meet the broad range of current and future mission requirements on inland and intracoastal waterways while reducing the environmental impact through green technologies; and
- Compile a knowledge base of Arctic technology and activities, including those by government, industry, and foreign entities to support establishment of requirements for, and the acquisition of, appropriate U.S. Coast Guard capabilities to support our evolving Arctic missions.

Significant Accomplishments in Research:

- Conducted proof of concept evaluations of four heavy oil detection systems; selected two systems for further testing;
- Provided analysis of potential problem areas in Mass Rescue Operations and targeted opportunities for further research, as well as potential technological improvements. Documented issues that hamper efficient response, as well as the need for training and simulation capability; and
- Evaluated persistent lighter-than-air and fixed-wing aircraft concepts, including High Altitude Long Endurance UAVs that could support multi-sensor wide area surveillance payloads anchored by long-range radar.

S&T

S&T develops new standards, educates the next-generation workforce and conducts testing and evaluation activities to further increase the security of the Nation.

Major New Applications Developed During the Year:

In FY 2008, S&T made progress in the development of an automated biological threat detection system which will be piloted by the Department in FY 2009. This automated detection system will identify airborne biological agents and notify the authorities when a positive test occurs giving medical and public officials time to respond to incidents. S&T also demonstrated a prototype countermeasure to protect aircraft from shoulder fired missiles along with a remote launch detection system that would lessen the amount of technology that each plane would have to carry.

2. Investments in Human Capital

Investments in Human Capital include expenses incurred for programs to educate and train the public. These programs are intended to increase or maintain national productive capacity as evidenced by outputs and outcomes. Based on a review of the Department's programs, FEMA and TSA have made significant investments in Human Capital.

FEMA

The mission of the Center for Domestic Preparedness (CDP) is to operate a federal training center for the delivery of high-quality, comprehensive, and relevant training programs for the nation's emergency responders. The CDP training program contributes to the DHS vision of creating a safe, secure America by offering training programs that lead to an emergency response community prepared for and capable of responding to all-hazards events. Located in Anniston, Alabama, the CDP is the Nation's and the Department of Homeland Security's only federally chartered training center that provides toxic agent training to emergency responders.

TSA

The Highway Watch Cooperative Agreement between TSA and the American Trucking Association (ATA) supports ATA's Highway Watch program, which educates highway professionals to identify and report safety and security situations on our Nation's roads. The program provides training and communications infrastructure to prepare 400,000 transportation professionals to respond in the event they or their cargo are the target of a terrorist attack and to share valuable intelligence with TSA if they witness potential threats. The intelligence allows Federal agencies and industry stakeholders to quickly move to prevent an attack or to immediately respond if an attack occurs.

3. Investments in Non-Federal Physical Property

Investments in Non-Federal Physical Property are expenses included in the calculation of net cost incurred by the reporting entity for the purchase, construction or major renovation of physical property owned by State and local governments. TSA has made significant investments in non-Federal physical property.

TSA

Airport Improvement Program. To help facilitate EDS installations, TSA purchases and installs in-line EDS equipment through a variety of funding mechanisms, including Congressionally authorized Letters of Intent (LOI). Since the modifications tend to be so expensive, the LOI is used to offset the physical modification costs incurred by commercial service airports for the modifications. TSA issued eight LOIs in FY2007 and another three agreements in FY 2008.

Airport Renovation Program. Another funding mechanism employed by TSA are Other Transaction Agreements (OTA) that exist for one year and establish the respective cost-sharing obligations and other responsibilities of the TSA and the specific entity (Board, Port, or Authority) related not only to the installation of integrated and non-integrated EDS and ETD equipment, but also to the improvements to be made to the existing systems in the baggage handling area. TSA entered into OTAs with 27 airports in FY2007 and another 15 in FY2008. All work will be completed in order to achieve compliance with the Aviation and Transportation Security Act (ATSA) Public Law 107-71, November 19, 2001.

Port Security Grant Program. This program provided grants to critical national seaports to support the security efforts at the port through enhanced facility and operational security. These grants contribute to important security upgrades such as surveillance equipment, access controls to restricted areas, communications equipment, and the construction of new command and control facilities. TSA has not had any programmatic or administrative responsibilities for this grant program since FY 2004.

Intercity Bus Security Program. This program provides funds to improve security for operators of fixed route intercity and charter bus services. TSA awards grants based on the users of funds outlined in section 1532(b) of Public Law 110-53, more commonly known as the "9/11 Act." Funding priorities reflect the Department's overall investment strategy, including risk-based funding and regional security cooperation. Funding priorities are collaboratively developed with transit security partners based on threat, vulnerabilities, and transit system assessment results. Priority is given to projects that can be implemented quickly, and have a high return on investment. By developing clear funding priorities and a scoring methodology that reflects those priorities and risk, TSA is able to ensure that grant dollars are spent appropriately.